Supreme Court, U.S.
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No. 99-1883

IN THE

Supreme Court of the United States

R&W TECHNICAL SERVICES, LTD. and GREGORY M. REAGAN,

Petitioners,

—v.—

COMMODITY FUTURES TRADING COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether under section 1a(5) of the Commodity Exchange Act, publishers of software that provides impersonal commodity trading recommendations are "commodity trading advisors?"

2. Whether misrepresentations in publishers advertisements to sell their software are "in connection with" any order to make or the making of any commodity futures contract for or on behalf of any other persons under section 4b(a) of the Commodities Exchange Act?

LISTING OF PARTIES, PARENT COMPANIES AND SUBSIDIARIES

All parties to the proceeding in the court whose judgment is sought to be reviewed are named in the caption.

There is no parent corporation or publicly held company owning 10% or more of the stock (or other interest) of petitioner R&W Technical Services, Ltd.

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PRELIMINARY STATEMENT

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 205 F.3d 165 and is reproduced at App. A-1. The opinion of the Commodity Futures Trading Commission is unofficially reported at Comm. Fut. L. Rep. (CCH) ¶28,018 (CFTC 1999) and is reproduced at App. A-49.

The judgment of the court of appeals sought to be reviewed was entered on February 24, 2000. Jurisdiction to review the judgment by writ of certiorari is conferred on this Court by 28 U.S.C. § 1254(1). No notification is required by Sup. Ct. Rule 29(b).

This case involves questions of interpretation of Commodity Exchange Act, §§ 1(a)5, 4b(a) and 4o, 7 U.S.C. §§ 1(a)(5), 4b(a) and 6o, which are reproduced at A-175.

STATEMENT OF THE CASE

Petitioners published and sold computer software. The software could only be used with real-time (i.e., contemporaneous) commodity trading data that the software purchaser could acquire from third parties unconnected with

petitioners.

The software was designed to generate impersonal buy and sell signals on the user's computer screen for the trading of commodity futures contracts, based on the pre-set formulas embedded in the software and on the real-time data. The impersonal buy and sell signals resulted from the software's recognition of current trading patterns that resembled historical patterns of profitable trades.

The software's signals to buy or sell were completely impersonal. The personal characteristics or financial situation of the users of the software did not affect the signals it generated. Users were under no obligation to act upon any signal and were entirely free to utilize or ignore the signals as they saw fit.

Petitioners did not act as brokers, traders or otherwise in the commodity futures trading market. Petitioners had no knowledge of whether particular users actually acted upon any signals. Nor was petitioners' revenue dependent on whether the software's signals were accepted or not. Petitioners' sole compensation was the purchase price they received from the sale of the software.

Petitioners advertised the software in magazines and other print media. Some of the advertisements reported highly profitable results that petitioners obtained by using the software. Those results had in fact been achieved by petitioners on their computer using real-time trading data and following the signals generated by the software. The advertising did not disclose that petitioners' trades were not actually executed in the marketplace. However, there was no evidence that petitioners' results would have been less profitable if their computer trades had been executed in the marketplace.

On March 19, 1996, the Commodity Futures Trading Commission (the "Commission") commenced an administrative proceeding against petitioners pursuant to section 6(c) of the Commodity Exchange Act(the "CEA"), 7 U.S.C. § 9. After an evidentiary hearing, an Administrative Law Judge found that petitioners had violated the statute and imposed a civil penalty of $7,125,000.

On appeal, the Commission conducted a de novo review and entered its final Order on March 16, 1999. The Commission held that petitioners had violated CEA § 4b(a) because their advertising for the software constituted fraud "in connection with" the trading of commodity futures contracts

for or on behalf of others. The Commission also held that petitioners' fraud violated § 4o of the CEA because petitioners were commodity trading advisors as defined in CEA § 1a(5). The Commission imposed a civil penalty of $2,375,000.

Petitioners appealed to the United States Court of Appeals for the Fifth Circuit, pursuant to section 6(c) of the CEA, 7 U.S.C. § 9. On February 24, 2000, the Court of Appeals' order affirmed the Commission's order as to liability, but reversed and remanded for a new determination as to the amount of the civil penalty. No further proceedings have occurred, except issuance of the Court of Appeals' mandate.

REASONS WHY CERTIORARI SHOULD BE GRANTED

Question 1:

Whether publishers of impersonal publications are commodity trading advisors is of great importance to the rapidly expanding numbers of print, electronic and internet publishers of impersonal commodity trading advice.

Under the CEA, commodity trading advisors are subject to discretionary licensing and a wide array of fiduciary and other obligations. The Seventh Circuit has described some of these obligations as follows:

> To avoid a criminal violation, financial publishers must first obtain and then maintain their licenses as registered commodity trading advisors. The CFTC has enormous power to refuse a publisher's request for a license and to revoke a license once issued. The Commission is authorized by 7 U.S.C. §12a(3)(A) to refuse registration or to revoke the license of a person or entity who is found to have violated any provision of the Commodity Exchange Act (including the

> registration requirement). The CFTC may also refuse to register or may revoke a license if "there is other good cause," 7 U.S.C. § 12a(3)(M). The Commodity Exchange Act does not provide a definition of "good cause."

Commodity Trend Service v. CFTC, Inc., 149 F.3d 679, 681 (7th Cir. 1998).

The CEA's definition of "commodity trading advisor" is modeled after the Investment Advisers Act's ("IAA") definition of "investment adviser." In Lowe v. SEC, 72 U.S. 181 (1985), the Court held that the IAA's definition of investment adviser did not include impersonal publishers. The Court reasoned that in adopting the IAA, Congress was concerned with personalized relationships and did not intend to violate the First Amendment's prohibition of prior restraints of speech.

Although very similar, the two statutory definitions are not identical. Like the IAA's definition of investment adviser, the CEA's definition of commodity trading advisor excludes publishers of impersonal publications, among other exclusions. However, unlike the investment adviser definition, the commodity trading advisor definition contains a further subsection limiting the statutory exclusions.

CEA § 1(a)(5)(C) states as follows:

> (C) INCIDENTAL SERVICES. Subparagraph (B) shall apply only if the furnishing of such services by persons referred to in such paragraph (B) is solely incidental to the conduct of their business or profession.

The interpretive question is whether, consistent with Lowe's analysis, "such services" in (C) relates, only to personalized services or whether the term is so broad as to effectively deprive commodity-oriented publications of the exclusions in subsection (B).

The Fifth Circuit rejected as inapplicable the argument that the statute should be interpreted so as to avoid grave constitutional questions. See 205 F.3d at 175-6. It held that petitioners were commodity trading advisors because their impersonal software generated buy and sell signals. The Commission interpreted the definition without reference to any First Amendment considerations or the doctrine of constitutional avoidance.

There is no conflict yet among the circuit courts of appeal. However, two district courts have held that commodity trading advisor

includes wholly impersonal publishers, but then have found the registration provisions of the CEA unconstitutional as applied to impersonal publishers. Taucher v. Born, 53 F. Supp.2d 464 (D. D.C. 1999); Commodity Trend Service v. CFTC, 1999 U.S. Dist. LEXIS 15877 (N.D. Ill. Sept. 29, 1999). These courts did not consider the constitutional avoidance doctrine. Another district court, relying on Lowe, has held that impersonal publishers are not commodity trading advisors. Ginsburg v. Agora, Inc., 915 F. Supp. 733 (D. Md. 1995). A fourth district court held that an impersonal publisher was a commodity trading advisor because it had a few personal contacts with subscribers, even though no personalized advice had been given. CFTC v. AVCO, 28 F. Supp.2d 104 (S.D.N.Y. 1997).

The Commission very recently adopted Rule 4.14(a)(9), 65 F.R. 12538 (March 10, 2000), which, for the time being at least, exempts certain impersonal publishers from the registration provisions of the CEA, but not from the definition of commodity trading advisor. But the Rule, in its current form, still deprives publishers of exemption if the advice is also provided by telephone. See, e.g., id. at n.7. That requirement leaves large numbers of publishers still subject to the CEA in its entirety.

This is an important question because so long as there is doubt about the reach of the definition, constitutionally protected activities of publishers of impersonal commodity advice are either prohibited outright or chilled.

Petitioners do not attack the constitutionality of the statute. Rather, petitioners continue to seek a statutory interpretation that avoids the grave constitutional issues by excluding impersonal publishers from the definition of commodity trading advisors.

Question 2:

Whether misrepresentations in publishers' advertisements to sell their software are "in or in connection with" a commodity futures transaction for or on behalf of another person under section 4b(a) is a critical question. The answer directly affects the exponentially increasing numbers of publishers and sellers of software products used by today's consumers, who are executing increasing numbers of market transactions using their personal computers and the internet.[1] If the

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[1]Under Section 4b(a), it is unlawful for any person:

in or in connection with any order to make or

"in connection with" requirement is not made clear with respect to software publishers, technological and entrepreneurial innovation may be chilled and consumers' access to markets by may be impeded.

The Fifth Circuit held that petitioners' misleading advertisements for their software satisfied the "in connection with" requirement of CEA § 4b(a). That court endorsed the Commission's interpretation that "in connection with" is satisfied when the fraud "relates to the risk of trading and the primary purpose of purchasing the advice is to execute trades." A-20.

> the making of any contract of sale of any commodity for future delivery made, or to be made for or on behalf of any person
>
> > ...(i) to cheat or defraud such other person [or]...(iii) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract....
>
> (Emphasis added).

The court said that "the petitioners did not give their advice away and necessarily expected their customers to make trades." The court opined further that "no one spends several thousand dollars on sophisticated software package without intending to make trades." A-21.

This interpretation of the "in connection with" requirement is not reasonable because the omissions or misrepresentations were made solely in connection with the sale of R&W's software, and were not in connection with any individual or specific commodity futures transactions. In fact, once the software was paid for and delivered, petitioners had no substantive contact with customers or with any trading accounts that customers may or may not have established.

This Court has never ruled on the meaning of the "in connection with" requirement of section 4b(a). However, most courts have assumed that it has the same meaning as the corresponding "in connection with" language of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and Rule 10b-5. See, e.g., Saxe v. E.F. Hutton, Inc., 789 F.2d 105 (2d Cir. 1986).

This Court has suggested previously that the "in connection with" in section 10(b) and Rule 10b-5 means that the fraud must simply "touch" a

purchase or sale of securities. Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977); Superintendent of Insurance of New York v. Bankers Life & Casualty Co., 404 U.S. 6 (1971).

However, in United States v. O'Hagan, 521 U.S. 642 (1997), a securities fraud case involving the misappropriation of nonpublic information, the Court clarified that in order to satisfy the "in connection with" requirement, the securities transaction must be an essential part of the fraud:

> We turn next to the §10(b) requirement that the misappropriator's deceptive use of information be "in connection with the purchase or sale of [a] security." This element is satisfied because the fiduciary's fraud is consummated, not when the fiduciary gains the confidential information, but when, without disclosure to his principal, he uses the information to purchase or sell securities.

In the absence of any interpretation of CEA § 4b(a) by the Court, the Courts of Appeals' interpretations conflict. Saxe, 789 F.2d 105 (2d Cir. 1986) and Hirk v. Agri-Research Council,

Inc., 561 F.2d 96 (7th Cir. 1977), interpreted the language to mean that the fraudulent misrepresentation must concern the fundamental nature of a particular order or sale of a futures contract, such that the fraud must involve the quality of or the risks associated with the investment. However, the Fifth Circuit in this case held that "in connection with" is satisfied by a misrepresentation in advertising for products where those products may be used by customers as a basis for making trading decisions. This same interpretation was made in Commodity Trend Services, Inc. v. CFTC, 1999 U.S. Dist. LEXIS 15877 (N.D. Ill. Sept. 29, 1999), now pending before the Seventh Circuit.

The Commission's interpretation of "in connection with" is not entitled to Chevron[2] deference because it is not a reasonable interpretation. It is unreasonable to find that misrepresentations in publishers' advertisements to sell software are necessarily in connection with making commodities futures contracts merely because the software's subject matter concerns

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[2] See Chevron U.S.A. Inc. v. Nat'l Resources Defense Council, Inc., 467 U.S. 837 (1984).

commodities futures transactions. For example, in this case, petitioners' misstatements in their advertisements concerned R&W's track record, bank account and guarantee, and were not made as to, with reference to, or otherwise "in connection with" any particular futures contract that a software customer might at some later date wish to buy or sell.

Software provides a tool for consumers to use or not. The uncertainty and inconsistency in the law puts software publishers and consumers unnecessarily at risk. Clarification of the "in connection with" requirement is necessary to resolve the existing conflict.

CONCLUSION

For the foregoing reasons, petitioners respectfully pray for issuance of a writ of certiorari to the United States of Appeals for the Fifth Circuit.

Dated: New York, New York
May 23, 2000

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1. R&W Technical Services, Ltd. Commodity Futures Trading Commission, (5th Cir., February 24, 2000, as corrected on on March 1, 2000

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No.99-60182

R & W TECHNICAL SERVICES LTD.; GREGORY M. REAGAN,

Petitioners

versus

COMMODITY FUTURES TRADING COMMISSION,

Respondent

Petition for Review of an Order of the Commodity Futures Trading Commission

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Before HIGGINBOTHAM and SMITH, Circuit Judges, and FALLON[1], District Judge.

PATRICK E. HIGGINBOTHAM, Circuit Judge:

Petitioners petition for review of a final order of the Commodity Futures Trading Commission affirming violations of the Commodities and Exchange Act and assessing a civil monetary penalty of $2.375 million. We AFFIRM the finding of liability, but find that the civil monetary

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[1]District Judge of the Eastern District of Louisiana, sitting by designation.

penalty imposed was not reasonable in light of the violations at issue and that in assessing the penalty, mitigating evidence was improperly excluded from consideration. WE REVERSE the order imposing a civil penalty and REMAND for a new assessment consistent with this opinion.

I.

From April 1993 to March 1996, the petitioners, R&W Technical Services, Ltd., sold computer software to individuals interested in trading commodity futures contracts. This software required users to provide a source of real-time financial data which the software analyzed each day. Based on preset formulas and the real-time data, the software made buy and sell recommendations that the user was advised to act upon at the open of trading the next day. In order to help sell the software, the petitioners' advertisements included claims of enormous profits made during their seven years of trading with this system.

The advertisements characterized these results as "certified." The advertisements claimed that one reason R&W was selling this proprietary software was to generate more capital which they could invest with their system. Some advertisements stated that the software was only

available in "limited quantities" and encouraged buyers to act quickly. The petitioners sold upwards of 1,000 copies of their software for prices of approximately $2,500 per copy. The advertisements offered to refund the purchase price plus 10 percent if the user did not show a profit after a year of using the system; apparently, only 11 customers ever requested a refund.

What the petitioners neglected to mention in their advertisements is that they never tested their system by making any trades in actual markets with real money. Instead, all of their performance data came from "paper" trades. In other words, the petitioners ran their system on real-time data but only pretended to perform the trades which their program recommended. The petitioners kept track of these virtual gains and losses and then presented the results as having been obtained with real cash.

On March 19, 1996, the Commodity Futures Trading Commission filed a four-count administrative complaint against the petitioners and its constituents, Gregory M. Reagan and Marshall L. Worsham individually, alleging violations of the Commodity and Exchange Act (CEA).[2] Count I alleged fraud in the solicitation of

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[2]See 7 U.S.C. § 1 et seq.

customers in violation of CEA § 4b(a) (i) and (iii). Count II alleged that the sellers were acting as Commodity Trading Advisors (CTAs) without being registered, in violation of CEA § 4m(1). Count III alleged fraudulent sales practices and fraudulent advertising as CTAs in violation of CEA § 4o(1) and Commission Rule 4.41(a). Count IV charged the petitioners with failure to produce required records and books. Reagan and Worsham also were charged as aiders and abettors and controlling persons for R&W's violations. On December 1, 1997, an Administrative Law Judge found R&W and Reagan[3] liable on all counts and imposed a civil penalty of $7.125 million.

On May 16, 1998, the petitioners timely moved to reopen the hearing for evidence of customer satisfaction which might mitigate the penalty. On March 16, 1999, after de novo review, the Commission affirmed in part and reversed in part the ALJ decision. The Commission affirmed violations under Count I (fraudulent solicitation) and Count III (fraudulent advertising). The Commission declined to reach Count II (failure to register as a CTA) or Count IV (record keeping). The Commission denied the request to reopen the hearing for mitigating evidence, ordered the sellers to cease and desist from their violations,

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[3]Worsham died in 1996.

and imposed a penalty, jointly and severally, of $2.375 million. The sellers then petitioned for review of the Commission's final order.

II.

A.

The petitioners contend that there is insufficient evidence to support a finding of materiality, an element of fraudulent solicitation under CEA § 4b(a) (i) and (iii).[4] Whether a misrepresentation is material is "a mixed question of law and fact," involving the "application of a legal standard to a particular set of facts."[5] A deferential standard applies to questions of law encompassed by the agency's expertise so long as the agency's conclusion is reasonable.[6] However, "'[w]hen the question is of the sort that courts commonly encounter, de novo review is proper."[7] Because materiality in allegedly fraudulent

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[4]See, e.g., Herman v. T&S Commodities, Inc., 592 F. Supp. 1406, 1416 (S.D.N.Y. 1984).

[5]TSC Indus v. Northway, Inc., 426 U.S. 438, 450 (1976).

[6]See Ryan v. CFTC, 145 F.3d 910, 916 (7th Cir. 1998).

[7]See, id., (quoting Monieson v. CFTC, 996 F.2d 852, 858 (7th Cir. 1993)).

transactions is a question that courts often encounter, de novo review is proper at least insofar as the application of the law to the Commission's findings of facts, which are conclusive "if supported by the weight of evidence."[8]

In this case, the petitioners misrepresented hypothetical trading results as real trading results. They sold software proclaiming that high profits had been obtained through actual trading over a period of years. These results supposedly had been "certified." In fact, however, no actual trades were ever made with their system. Instead, all results were simulated, and the petitioners risked no money in testing their system.

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[8]CEA § 6(c).

A statement or omitted fact is "material" if there is a substantial likelihood that a reasonable investor would consider the information important in making a decision to invest.[9] We have little hesitation in saying that a reasonable investor would regard as material the fact that the petitioners' trading system "had never been tested through actual trading."[10] Specifically, according to the Commission's expert, "hypothetical trading results have many inherent limitations." For example, such results assume a customer can execute his trade at the opening price. They also ignore the ability of a customer to steadfastly adhere to a particular trading scheme even when confronted with an initial series of losses. The petitioners attempt to characterize their method as not hypothetical or unreliable because their results were based on real-time data and not based on the benefit of hindsight. In the end, however, the problem with reporting hypothetical trading results as real is that it allows an unscrupulous seller to test an arbitrarily large number of potential investment systems at little cost and then merely market the ones that

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[9]See TSC Indus., 426 U.S. at 449.

[10]Levine v. Refco, Inc., (1987-1990 Transfer Binder) Comm. Fut. L. Rep. (CCH), ¶24,488, at 36, 115 (CFTC July 11, 1989).

happen to do best. Even if each system tested used real-time rather than historical data, the choice of which system to market introduces a hindsight bias.

If real money is used in testing, a seller cannot afford to indulge in such cherry-picking, which means investors can have more confidence in the seller's claims. There is no allegation that R&W tested multiple systems and only marketed the best, but this rationale nevertheless explains why any reasonable investor would be skeptical when hypothetical results are portrayed as real.[11] The petitioners' advertisements proclaimed that the money made through their software sales was plowed back into real trades using their system. This also was a misrepresentation. The Commission found that the use of a trading system by its developers is a sign of authenticity, which reasonably increases consumer confidence in buying and using the system. The petitioners contend that these representations were of no additional benefit to consumer confidence, given

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[11]See also, In re Armstrong, [1994 - 1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26, 332, at 42, 612 (CFTC Mar. 10, 1995), aff 'd, 77 F.3d 461 (3d Cir. 1993)(rejecting an argument identical to the petitioners).

that the petitioners already offered a money-back guarantee and had placed their corporate logo on the product. Actual futures trading, however, creates exposure to substantial risk. A claim that one trades pursuant to the system one sells clearly expresses a higher level of confidence than merely putting a corporate logo on the product and offering a full refund. The petitioners also misrepresented the risks of futures trading by making bold predictions of high profits. Such claims "amount [ ] to the type of guarantee of profit prohibited under Section 4b of the Act."[12] The petitioners respond that their guarantee of profits was backed only by a refund policy, which clearly established the only risks they insured against. However, the existence of a limited refund policy coupled with extravagant claims of false profits only. confirms that the petitioners misrepresented the existence of the substantial risks inherent in futures trading.[13]

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[12]Levine, ¶24,488, at 36, 115.

[13]Rule 4.41(b) requires that certain disclosures about risk be made when presenting the performance of hypothetical commodity accounts. The petitioners protest that they were not charged with violating Rule 4.41(b) .This is true, but we also do not find any violation of Rule 4.41(b) was improperly used to buttress any fraudulent solicitation violation.

The petitioners argue that the Commission presented little evidence that actual trading would have been very different from real trading. However, even accepting the petitioners' characterization of the evidence as true does not change the fact that their statements were fraudulent and would have made a difference to a reasonable investor, even if the difference in practice did not produce catastrophic losses. As the Commission reasoned, a claim of "actual trading can convey to a customer that 'these results have been achieved,' [whereas] the petitioners' method can only convey that 'these results might have been possible."[14] Because simulated results inherently overstate the reliability and validity of an investment system, and because extravagant claims understate the inherent risks in commodities trading, a reasonable investor would find the petitioners'

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[14] In re R&W Technical Services. Ltd., No.96-3, 1999 WL 152619, at *20, Comm. Fut. L. Rep. (CCH) ¶27.582 (CFTC Mar. 16, 1999].

fraudulent misrepresentations to be material.[15]

B.

CEA § 4b(a) prohibits any person from defrauding another person "in or in connection with" a commodity futures contract. The Commission interprets "in connection with" to reach the petitioners' conduct, while the petitioners dispute that any alleged misrepresentations were made "in connection with" any commodity futures contracts. To resolve this dispute, we first must determine the proper standard of review.

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[15]See CFTC v. AVCO Financial Corp.,28 F. Supp. 2d 104 (S.D.N.Y. 1998) (finding similar misrepresentations to be material), appeal pending sub nom. Vartuli v. CFTC, No.98-6280 (2d Cir.) ; cf., CFTC v. Skorupskas, 605 F. Supp. 923, 933 (E.D. Mich. 1985) (finding similar misrepresentations to violate CEA § 4b(a)).

1.

To the extent that a legal question involves the interpretation of the CEA, the Commission should normally be accorded a high level of deference,[16] since the Commission is entrusted with administering the CEA through rules and regulations.[17] Moreover, the Commission administers the CEA not only through its rulemaking authority, but also through its adjudicative power.[18] As this court has stated, "[e]ven the adjudicative interpretations of policy-making agencies are entitled to Chevron deference."[19]

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[16]See, Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843-44 (1984).

[17]See, e.g., 7 U.S.C. § 4a(j).

[18]See, e.g., 7 U.S.C. § 9, 13.

[19]Microcomputer Technology Institute v. Riley, 139 F.3d 1044, 1047 (5th Cir. 1998).

In the present case, however, Congress has given adjudicative authority not only to the\ Commission, but also to the federal district and appellate courts, both in terms of reviewing Commission orders and decisions and in terms of original jurisdiction over certain types of actions.[20] However, the Commission remains the only governmental body entrusted with rulemaking authority in this area of law, and thus still remains the primary authority for interpretive policy decisions.[21]

Although the federal appellate courts have the power to review Commission orders and decisions, and although the district courts have been granted original jurisdiction in certain cases under the CEA, nothing in the CEA purports to lower the standard of review of Commission orders and decisions with respect to questions of statutory interpretation. Thus, because the phrase "in connection with" is a term of ambiguous scope, and because the Commission is the primary policy maker in this area, we find

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[20]See 7 U.S.C. § 9, 13a-1, 13a-2.

[21]Cf. Salleh v. Christopher, 85 F.3d 689 (D.C.Cir. 1996)(declining to determine relative primacy when two governmental entities asserted truly conflicting claims of interpretative authority).

no reason to depart from regular Chevron deference, despite the fact that federal courts at some times may be called upon in an original action to interpret the CEA regarding a provision whose meaning has not yet been interpreted by the Commission in a rule or adjudication.

However, if there is no prior interpretation by the Commission, any question of Chevron deference becomes moot. Instead, interpretations advanced by the Commission during the litigation may be construed as offered for the purpose of "provid[ing] a convenient litigating position"; if so, the Commission's interpretation would not be entitled to deference.[22]

If a federal court answers a question of statutory interpretation before the Commission, then that court's interpretation may later conflict with an interpretation adopted by the Commission in a later rule or case. The resolution of such a conflict, however, is not before us, since the federal cases which have interpreted "in connection with" have not constricted the phrase any narrower than the

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[22]See, e.g., United States v. Food, 2,998 Cases, 64 F.3d 984, 987 n.5 (5th Cir. 1995) (citing Irving Indep. Sch. Dist. v. Packard Properties, 970 F.2d 58, 64 (5th Cir. 1992)).

Commission has interpreted it in its decisions. Thus, we must defer to the Commission's interpretation unless it is unreasonable.[23]

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[23]See Chevron, 467 U.S. at 843-44.

2.

In order for a fraudulent statement to be "in connection with" a commodities future contract as required by § 4b(a), the statement must first misrepresent the fundamental risk associated with such investments.[24] Misrepresentations regarding the tax status of a commodities account are not actionable,[25] nor are misrepresentations regarding commissions.[26] The plain language of § 4b(a) requires the misrepresentation to have some connection with the trading of commodity futures contracts. At issue is how tenuous that connection can be.

While it is clear that the petitioners' advertising claims misrepresented the fundamental risk associated with commodity futures investments and trading systems, the unusual aspect of this case is that the petitioners executed no trades for customers. They only sold software. In essence,

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[24]See, e.g., Kearney v. Prudential-Bache Securities, Inc., 701 F. Supp. 416, 424-26 (S.D.N.Y. 1988).

[25]See, id.

[26]See Williamsport Fireman Pension v. E.F. Hutton & Co., 567 F. Supp. 140 (M.D. Pa. 1983).

the petitioners provided investment recommendations, but did not have any additional discretion to make trades on behalf of their customers. The petitioners generally profited only from the sale of software and not from the trading of their customers.[27]

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[27]In point of fact, however, one of the first sales R&W made was to a commodities broker who financed the purchase by paying R&W a portion of each commission he charged his customers whenever he made a trade based on R&W's system. Clearly, any misrepresentations in that particular sale would have been in connection with commodity futures contracts because R&W sold the system with the intent of being paid from commissions made using the recommendations of the software. However, this apparently was an atypical sale and not the basis for the Commission's general complaint.

In Saxe v. E.F. Hutton & Co.,[28] another fraud case under the CEA, a broker solicited the opening of a discretionary account by misrepresenting the experience and skills of another broker who was to trade for the account.[29] In the instant case, the petitioners' misrepresentations regarding the reliability of their system are analogous to the broker in Saxe misrepresenting another broker's track record. Unlike the broker in Saxe, however, the petitioners' customers only purchased recommendations from the petitioners. The petitioners had no authority to execute any trades on their customer's behalf, whether at the customer's request or at the petitioners' discretion. In one sense, then, the "connection" between the fraud and trades in Saxe is two levels closer than in the current case. The broker in Saxe had both the customer's money and the customer's permission to execute trades.

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[28]789 F.2d 105 (2d Cir. 1986).

[29]Id. at 110.

In Clayton Brokerage v. CFTC,[30] however, the Eleventh Circuit found misrepresentations to be "in connection with" commodity trading regardless of whether the account was discretionary or traded only at the request of the customer. Clayton Brokerage is thus only one level removed from our case, in which the petitioners made recommendations but did not have any direct stake in the trading.

Moreover, although the petitioners did not profit from customer trading by receiving commissions, the petitioners did not give their advice away and necessarily expected their customers to make trades. This expensive software had no purpose except as a device for choosing which trades to make. In the end, then, the question is whether the phrase "in connection with" can reasonably be read to reach the petitioners' fraud.

Under the Commission's interpretation, fraud in the sale of investment advice will be "in connection with" the sale of a commodities future contract if the fraud relates to the risk of the trading and the primary purpose of purchasing the advice is to execute trades. Under this interpretation, the fraud here can be understood as more similar to the fraud in Clayton Brokerage and Saxe than first appears. The only purpose

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[30]794 F.2d 573, 582 (11th Cir. 1986).

for depositing money in a commodity account is to subsequently make trades, either on one's own initiative or at the recommendation or discretion of the broker. Similarly, no one spends several thousand dollars on a sophisticated software package without seriously intending to execute trades.

These scenarios contrast markedly with other sales of investment advice. For example, magazine and newspaper articles often dispense investment advice on a variety of topics. A person may buy a newspaper or magazine to read such articles with no intention to follow through on any of the recommendations. Such sources are invariably used not only for educational and research purposes, but also entertainment or leisure purposes. The same, however, cannot be said about petitioners' software. As the Commission noted below:

> unlike the cases that have found the connection between the fraud and trade lacking, the misrepresentations in this case are neither incidental nor secondary to the futures trading but are directly related to that trading. In fact, the gravamen of the claim is that the respondents misled potential purchases of their system concerning

trading profits and trading risks in order to induce customers to trade, and there is ample evidence to show that they did trade.[31]

[31] In re R&W Technical Services, Ltd., No. 96-3, 1999 WL 152619, at *23, Comm. Fut. L. Rep. (CCH) ¶27, 582 (CFTC Mar. 16, 1999).

There are additional reasons to construe § 4b(a) broadly rather than narrowly. Originally, § 4b(a) only applied to members of a contract market. In 1968 it was extended to reach "any person."[32] In fact, "[t]he legislative history [of § 4b(a)] indicates a progressive trend toward broader application of the CEA."[33] In 1974, Congress gave the Commission even greater enforcement powers, in part because of the fear that unscrupulous individuals were encouraging amateurs to trade in the commodities markets through fraudulent advertising.[34] Remedial statutes are to be construed liberally,[35] and in an era of increasing individual participation in commodities markets, the need for such protection has not lessened.

The Commission's position in its earlier adjudication of this case is consistent with CFTC

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[32]See Pub. L. 90-258, 82 Stat. 27 (1968).

[33]Saxe, 789 F.2d at 111; see also Hirk v. Agri-Research Council, Inc., 561 F.2d 96, 103-04 ("The plain meaning of such broad language [as "in connection with"] cannot be ignored.").

[34]See Saxe, 789 F.2d at 111.

[35]See Monieson v. CFTC, 996 F.2d 852, 859 (7th Cir. 1993).

v. AVCO Financial Corp.[36] and does not conflict with any earlier interpretations by the federal courts. The petitioners defrauded customers regarding the reliability of a system whose only intended use was as a means of selecting commodity futures contracts. To say that such fraud is "in connection with" commodity futures contracts is not unreasonable. Given the standard of review, we must affirm the Commission's findings of liability under § 4b(a).

III.

The petitioners were also charged with violating CEA § 4o and Commission Rule 4.41(a), which prohibit Commodity Trading Advisors ("CTAs") from defrauding clients and prospective clients through various schemes including false advertising. At issue is whether the petitioners were functioning as CTAs.

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[36] 28 F. Supp. 2d 104 (S.D.N.Y. 1998), appeal pending sub nom. Vartuli v. CFTC, No. 98-6280 (2d Cir.) (finding nearly identical misrepresentations in the sale of software to be "in connection with" futures contracts).

A.

A CTA is defined as any person who "from compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in [futures contracts]."[37] Excluded from this definition is any "publisher or producer of any print or electronic data of general and regular dissemination, including its employees."[38] However, the publisher exception only applies if the CTA's "furnishing of such services . . . is solely incidental to the conduct of their business."[39] The Commission argues that "such services" refers to "any advisory services," while the petitioners argue that it refers only to "personalized advisory services."

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[37]7 U.S.C. § 1a(5)(A).

[38]7 U.S.C. § 1a(5)(B).

[39]7 U.S.C. § 1a(5)(C).

The plain language of the statute, however, shows that the phrase refers to "any advisory services. " Section la (5)(A)(i) defines a CTA as any person who "engages in the business of advising others, either directly or through publications, writings, or electronic media." Absent any other distinctions, the later reference to "such services" can only refer to both the direct and indirect provision of advisory services. This might appear to vitiate the entire publisher exception, since the publishing of such advice may often be the primary business of a publisher. However, the exclusion still protects incidental publishers of such advice, such as general magazines and newspapers, even if it does not exclude publishers who specifically concentrate on commodities and futures advice. To accept the petitioners' interpretation, however, would allow any large publishing company to offer highly personalized trading advice on the side -- such as a 1-800 number trading hotline -- without having to conform to the rules regulating commodity trading advisors, so long as the service was "incidental" to their regular impersonalized publishing activities. For these reasons, the

Commission's interpretation is the correct one.[40]

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[40]Even if we accepted that the statutory definition of CTA was ambiguous, we would defer to the Commission's interpretation under Chevron since it is not unreasonable. Similarly, the fact that Congress included "selling subscriptions" within the listed activities of CTAs, and referred to a CTA's "subscribers" supports the notion that Congress intended to regulate impersonal publishers, since the selling of subscriptions necessary involves the publishing of impersonal advice. Legislative history of the CEA also supports the idea that Congress intended to protect the commodities market from the improper influences of impersonal advisors. See H.R. Rep No. 93-963, at 37 (1974) (describing CTAs as "individuals who are involved either directly or indirectly in influencing or advising the investment of customers' funds in commodities" (emphasis added)); id. at 54-55, 68 (expressing concern for potential market manipulations occurring when advisors make impersonalized, identical recommendations to their customers).

Alternatively, we note that the petitioners' software publishing was neither "generally" nor "regularly" disseminated, as required in order to meet the publishing exception.[41] In Lowe v. SEC,[42] the Supreme Court dealt with an even broader publisher exception within the Investment Advisers Act of 1940. The Court defined regular dissemination to require that "there is no indication that [dissemination] ha[s] been timed to specific market activity."[43] In this case, the petitioners' recommendations were provided by software that was programmed to "speak" only when certain market conditions were met. Thus, the petitioners' recommendations were timed to particular market activity and not "regularly" disseminated.

Moreover, a publication is only of "general" dissemination when it is circulated for sale to the

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[41]See 7 U.S.C. § 1a(5)(B)(iv)

[42]472 U.S. 181 (1985).

[43]Id. at 209.

general public at large in an open market.[44] The record here indicates that the petitioners advertised that the software would only be sold in limited numbers. While that may have been a selling tactic, such claims cut against their argument that their software was "generally" disseminated.

[44]See id. at 210.

The petitioners contend, however, that under Lowe, "impersonal" publishers of investment advice cannot be CTAs. In Lowe, the Court found that publishers of impersonal advice were not investment advisors under the Investment Advisers Act of 1940 (IAA),[45] which defined investment advisor to include persons who advised others indirectly through publications.[46] The Court found that the legislative intent behind the IAA was to regulate only the business of dispensing personalized advice and not to regulate impersonalized publishing activities; therefore, impersonal publishers were not included in the definition of "investment adviser."[47]

The petitioners in this case were impersonal publishers. The software they offered provided impersonal recommendations as to the buying and selling of commodities. Such

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[45]See id.

[46]See 15 U.S.C. § 80b-2(a)(ii).

[47]Lowe, 472 U.S. at 204, 207-08, 210.

recommendations were not based on any knowledge regarding the user's personal financial situation. Admittedly, this is a more sophisticated form of publishing than a weekly newsletter, but in substance it is the same as if the petitioners operated their proprietary software at home and faxed reports to their subscribers on a daily basis.

Just because Lowe found that the lAA excluded such publishers, however, does not entail that the CEA must. The statutes are different, and Lowe read the statute to avoid constitutional concerns. Had impersonal advisors been included in the definition of an investment advisor, there would have been an unconstitutional prior restraint in regulating them, since the publication of impersonal advice about specific investments is fully protected speech under the First Amendment.[48]

The Commission does not contest that such regulations would be a prior restraint, but instead argues that we need not consider that constitutional question because the validity of the

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[48]See id at 210 n. 58.

CEA's registration requirements is not before us. The petitioners are no longer charged with registration violations, and even if the registration requirements are unconstitutional, the rest of the CEA would remain intact under a severability clause.[49]

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[49] See 7 U.S.C. § 17; cf. Taucher v. Born, 53 F. Supp. 2d 464 (D.D.C. 1999)(finding that the CEA's registration provisions are unconstitutional).

Instead, the Commission argues that the CEA can define impersonal publishers as CTAs, even if the CEA cannot impose registration requirements upon them. Then, once the CEA has defined such advisors as CTAs, the CEA can impose liability on them for violations of the CEA's antifraud provisions, since liability for fraud would not run afoul of the First Amendment.[50]

In general, statutes should be construed so as to avoid constitutional questions.[51] However, the constitutional question in this case has already been avoided because the registration requirements are not before us. We find, then, that the petitioners fall within the plain meaning of the definition of CTA and thus are subject to the CEA's antifraud provisions which apply to CTAs. However, we do note that lower courts

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[50]See Lowe, 472 U.S. at 225 (White, J., concurring)(citing Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 651 (1985); Village of Schaumberg v. Citizens for a Better Env't, 444 U.S. 620, 637-38 (1980); Schneider v. State, 308 U.S. 147, 164 (1939)).

[51]CFTC v. Schor, 478 U.S. 833, 841 (1986).

have split on this issue.[52]

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[52]Compare Commodity Trend Serv., Inc. v. CFTC, 1999 WL 965962 (N.D. Ill. Sept. 29, 1999)(including impersonal publishers within the definition of CTA), on remand from 149 F.3d 679 (7th Cir. 1998), with Ginsburg v. Agora, Inc., 915 F. Supp. 733 (D. Md. 1995) (excluding such publishers from the definition of CTA).

B.

In order to apply § 4o and Commission Rule 4.41 to the petitioners, their advertising scheme must have been used to defraud potential "clients."[53] The petitioners argue that their customers were not clients because no personal relationship existed between the petitioners and their customers. While the CEA does not define "client," the petitioners urge that the common meaning of the term requires a personalized relationship.

In terms of Commission Rule 4.1, the Commission has previously interpreted it to apply to advertisements directed to mere subscribers of investment advice.[54] The Commission's interpretation of its own rule would, of course, be controlling... unless it is plainly erroneous or

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[53]See CEA § 4o(1); Commission Rule 4.41(a), (c).

[54]See, e.g., in re Armstrong [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26, 332 at 42, 612 (CFTC Mar. 10, 1995), aff'd, 77 F.3d 461 (3d Cir. 1996).

inconsistent with the regulation."[55]

[55]Bowles v. Seminole Rock Co., 325 U.S. 410, 414 (1945).

The petitioners' argument regarding § 4o, however, finds superficial support in cases such as Lowe, which distinguished between the impersonal publisher-subscriber relationship and "the investment adviser-client" relationship.[56] Lowe's distinction was made based on the IAA Act and not the CEA. However, even the CEA makes a distinction between clients and subscribers. For example, §4o and Rule 4.41(c) apply only to clients, while Rule 4.33(a) specifically applies to clients and subscribers.

The petitioners, however, failed to raise their argument regarding the definition of "client" before the Commission and instead simply argued that § 4o did not apply to them because they were not CTAs. We have held that "[a]s a general rule, in considering a petition for review from a final agency order, the courts will not consider questions of law which were neither presented to nor passed on by the agency."[57] Because we find no compelling reason to address this question of

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[56]Lowe, 472 U.S. at 210.

[57]Myron v.Martin, 670 F.2d 49, 51 (5th Cir. 1982).

interpretation for the first time on appeal, we do not decide the issue.

IV.

An agency's refusal to reopen the record is a procedural matter which is reviewable for an abuse of discretion.[58] In the present case, the Commission refused to hear testimony that demonstrated widespread customer satisfaction with the petitioners' product.

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[58]See Alaska Steamship Co. v. Federal Maritime Comm., 356 F.2d 59, 62-63 (9th Cir. 1966).

The reason the petitioners did not give such evidence at the ALJ hearing was because both the ALJ and enforcement counsel had indicated that whether the software worked as advertised was not at issue. The ALJ even excluded the Division's customer witness testimony as irrelevant. Yet after the hearing, the ALJ made findings of fact based on an assumption that no trading scheme could work as the petitioners advertised.[59] When the Commission then refused to hear evidence of customer satisfaction, the Commission stated that exculpatory evidence, including evidence of customer satisfaction, was not material because the Commission agreed that the efficacy of the system was not at issue.

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[59]See In re R&W Technical Services, Ltd., Comm. Fut. L. Rep. (CCH) ¶27, 193 at 45,727 n.75 (CFTC ALJ Dec. 1, 1997).

However, evidence of the efficacy of the petitioners' system was relevant in assessing sanctions.[60] The Commission now portrays the petitioners' failure to adduce evidence at the ALJ hearing as a tactical decision.[61] Such a characterization is hard to square with the fact that the ALJ and Division stated that the efficacy of the system was not at issue. Further, we see no tactical advantage the petitioners might have gained by holding back evidence that their customers were satisfied and had made rather than lost money. When the Commission conducted its review, its review was de novo. Thus, there was no need to exclude the defendant's mitigating evidence based on

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[60]See in re Grossfeld [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26, 931, at 44, 468 & n.30 (CFTC Dec. 10, 1996) (in assessing civil money penalties, the loss suffered by customers is one pertinent factor), aff'd in part and appeal dismissed in part, 137 F.3d 1300 (11th Cir. 1998).

[61]See In re Interstate Secs. Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25, 373, at 39, 261 (CFTC Aug. 27, 1992).

deference to prior factual findings. Because of the relevance of this mitigating evidence, and because the ALJ appears to have misled the petitioners as to the admissibility of this evidence, the Commission abused its discretion in refusing to reopen the record to hear this evidence, especially given that the ALJ originally imposed over a $7 million penalty based on a finding that no such trading system could provide a "trader with any significant market advantage." [62]

[62] R&W Technical Services, ¶27, 193, at 45,727 n.75.

V.

Sanctions are reviewed under the abuse of discretion standard.[63] The standard is that the sanction must be rationally related to the offense.[64] Given that the Commission should have considered evidence of the efficacy of the system and customer satisfaction, the penalty must be reassessed in light of such mitigating evidence. The improper exclusion of evidence aside, the original penalty was unreasonably excessive.

The penalty may be determined by focusing on the "relative gravity of ...misconduct" in light of factors such as:

> (1) the relationship of the violation at issue to the regulatory purposes of the Act; (2) respondent's state of

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[63]See Ryan v. CFTC, 145 F.3d 910, 916 (7th Cir. 1998).

[64]See Monieson v. CFTC, 996 F.2d 852 (7th Cir. 1993).

mind; (3) the consequences flowing from the violative conduct; and (4) respondent's post-violation conduct.[65]

[65] Grossfeld, ¶26, 921, at 44, 467-68.

Furthermore, "[t]he level of sanctions should reflect 'the particular mitigating or aggravating circumstances presented by the unique facts of the individual conduct at issue.' "[66] On occasion, penalties in similar cases have been "a guide to the appropriate level of a civil monetary penalty."[67] However, an undue focus on past penalties fails to account for changes in policy or inflation, and thus may undermine deterrence.[68] Federal courts have also rejected the notion that uniform sanctions must be imposed by an administrative agency for similar violations.[69]

Even if sanctions need not be precisely uniform, they must be rational, and neither inflation nor expressed policy changes can explain the

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[66]Id. (quoting In re Premex, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24, 165 (CFTC Feb. 17, 1988)).

[67]Id.

[68]See id.

[69]See Butz v. Glover Livestock Comm. Co., 411 U.S. 182, 187 (1973); Monieson, 996 F.2d at 864.

magnitude of the penalty in this case. At oral argument, counsel for the Commission was unable to say that there had ever been a fine greater than $100,000 in a case in which there had been no demonstration of harm to others. One case allowed a civil penalty of $1.8 million, but only after a defendant committed extensive solicitation fraud, his customers suffered losses of more than $2 million, and the defendant violated a cease and desist order.[70]

[70]See Grossfeld, ¶26, 921.

In calculating a civil penalty, "the financial benefit that accrued to the respondent and/or the loss suffered by customers as a result of the wrongdoing are especially pertinent factors."[71] In this case, the Commission had no evidence of customer losses and thus focused exclusively on the gain to the petitioners when approving a $2.735 million sanction based on estimated gross revenues. When a penalty is designed for deterrence and not restitution, however, the proper measure of gain to the defendant is net profits, not gross revenues.[72]

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[71] See id. & 44, 468 & n.34.

[72] See CFTC v. AVCO Financial Corp., No. 97 Civ. 3119, 1998 WL 524901, at *1 (S.D.N.Y. Aug. 21, 1998) (reducing $4.15 million penalty based on gross revenues to $700,000 penalty based on net profits).

Thus, the lack of demonstrated harm in this case suggests that the petitioners' violations, while actionable, were not so egregious as to warrant a $2.375 million penalty. Presumably, the petitioners' system worked better than the one at issue in CFTC v. AVCO Financial Corp.[73] In both AVCO and the present case, sellers portrayed hypothetical results as real results.[74] The evidence of actual losses suffered by AVCO's customers shows why such misrepresentations would be material to reasonable investors.[75] The lack of any demonstrated losses in this case makes plain that a $2.375 million penalty is capricious and indefensible. Even the Commission's witness, whose testimony demonstrated that the system did not perform as well in practice as in theory, earned a $60,000 profit in one year using the system and stated that no other system worked better.

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[73]28 F. Supp. 2d 104 (S.D.N.Y. 1998), appeal pending sub. nom. Vartuli v. CFTC, No. 98-6280 (2d Cir.)

[74]See id. at 115-117.

[75]See id. at 112-113.

The Commission has never imposed a penalty this large on any individual and has never imposed a penalty of even the same order of magnitude absent demonstrated harm to others. Thus, on remand a new assessment of the penalty should begin with the petitioner's net profits, which then should be adjusted lower based upon any mitigating evidence the petitioners present with regard to customer satisfaction.

AFFIRMED in part, **REVERSED** in part, and **REMANDED.**

2. In re R&W Technical Services, Ltd.
(CFTC, March 16, 1999)

UNITED STATES
Before the
COMMODITY FUTURES TRADING COMMISSION

In re R&W Technical Services, Ltd. Gregory M. Reagan, and Dorothy Mobley Worsham, as Executrix of the Estate of Marshall L. Worsham	)	CFTC Docket No. 96-3
	)	OPINION & ORDER

Respondents R&W Technical Services, Ltd. ("R&W") and Gregory M. Reagan ("Reagan") appeal from the initial decision, which found them liable for failing to register as commodity trading advisors, fraud in the solicitation of customers, and fraudulent advertising; found R&W liable for violating certain recordkeeping and production requirements; and found Reagan and Dorothy Mobley Worsham, as Executrix of the Estate of Marshall L. Worsham ("the Worsham estate"), liable as controlling persons for, and aiders and abettors of, R&W's violations. The Division of Enforcement ("the Division") also appeals from the

initial decision, which -- notwithstanding its award of civil monetary penalties, trading bans, and cease-and-desist orders -- failed to impose an award of restitution against respondents. The Division asks that we reverse and remand the initial decision with respect to the restitution issues and affirm the initial decision in all other respects. For the reasons that follow, the initial decision is affirmed in part, modified in part, and vacated in part.

BACKGROUND

1. Procedural History

This case arises out of a four-count administrative complaint filed by the Commission on March 19, 1996, against R&W Technical Services, Ltd. ("R&W"), a seller of computerized trading systems, and against its owners, Gregory M. Reagan ("Reagan"), and Marshall L. Worsham ("Worsham") (collectively, the "respondents"[1]).

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[1]Although the Worsham estate has been substituted as a respondent for Marshall Worsham, see infra, references to "respondents" when describing the factual circumstances in

Count I of the complaint charged respondents with fraud in the solicitation of R&W's customers in violation of Section 4b(a)(i) and (iii) of the Commodity Exchange Act , ("CEA" or "Act"), 7 U.S.C. ' 6b(a)(i) and (iii) (1994). Compl. ¶¶19-21.[2] Count II charged respondents with acting as commodity trading advisors ("CTAs") without the benefit of registration in violation of Section 4m(1) of the Act, 7 U.S.C. § 6m(1). Compl. ¶¶ 23-24. Count III charged respondents with engaging in fraudulent sales practices and fraudulent advertising as CTAs in violation of Section 4o(1) of the Act, 7 U.S.C. § 6o(1) (1994), and Commission Rule 4.41(a), 17 C.F.R. §

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this case are intended to contain a reference to Marshall Worsham, but not the Worsham estate. However, when we explain their legal arguments, or when we discuss findings of liability against them, references to "respondents" are intended to include a reference to the Worsham estate, but not Marshall Worsham.

[2]Citations to "Compl." and "Ans." are to the Commission's complaint and the respondents' answer, respectively. Citations to "DX _____" are to the Division of Enforcement's exhibits. Citations to "Tr. _____" are to pages of the transcript of the August 13, 1997 administrative hearing.

4.41(a)(1998). Compl. ¶¶ 27-28. Count IV charged R&W with failure to produce required records and books in violation of Section 4n(3)(A) of the Act, 7 U.S.C. § 6n(3)(A), and Commission Rules 1.31 and 4.33, 17 C.F.R. § 1.31 and 4.33. Compl. ¶¶ 31-33. In addition, Reagan and Worsham were charged as aiders and abettors and as controlling persons for R&W's alleged violations of the Act within the meaning of Section 13(a) and (b) of the Act, 7 U.S.C. § 13c(a) and (b). Compl. at ¶¶ 21, 22, 25, 26, 29, 30. In their answer, the respondents generally denied any wrongdoing.

Worsham died on September 13, 1996. On April 10, 1997, the ALJ granted the Division's Motion to Substitute Dorothy Mobley Worsham as Executrix for the Estate of Marshall Worsham ("the Worsham estate") as a respondent. In re R&W, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,030. The Division contended and the ALJ found that the claim for restitution survived Worsham's death because it was "remedial" rather than punitive. Id. at 44,892. The Division abandoned its claims against Worsham for civil monetary penalties, a trading ban and a cease and desist order. See Div.

Motion to Substitute Party (filed Jan. 6, 1997).[3]

After a period of discovery and a prehearing conference to resolve outstanding procedural, evidentiary, and administrative issues, the ALJ conducted an evidentiary hearing in Chicago, Illinois.

II. Factual Background

A. R&W Technical Services, Reagan, and Worsham

R&W, a Texas limited liability company, was

[3]Due to the absence of a motion to substitute regarding the claim for civil monetary penalties, we do not reach the issue whether a claim for civil monetary penalties survives the death of a respondent. Commission Rule 10.32, 17 C.F.R. § 10.32.

formed by Reagan and Worsham in late 1992 or early 1993. Ans.& 1; Tr. 99-100. During the period of time covered by the complaint (April 1993 - March 1996), R&W sold computerized trading systems that generate buy, sell and stop signals for commodity futures contracts. Ans. ¶ 1, 4; Tr. 143.[4] Reagan and Worsham were partners at R&W until Worsham's death in September 1996, at which point Reagan acquired sole ownership of the company. Ans. ¶¶ 2, 3; Tr. 99-100. Reagan, who created and developed the trading system, was responsible for the sale and technical support of the trading system, participated in the "day-to-day operation of the firm," solicited customers, and drafted and reviewed R&W's advertisements and promotional materials. Ans. ¶ 2; Tr. 105-06. Worsham, who provided all of the initial capital for R&W, was responsible for finances, administration, the

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[4]These systems (hereinafter "the R&W software") include "CurrencyMaster," "S&P Master, TreasuryMaster" and "EuroMaster," all four of which could be bought together as "Master Suite." Ans. ¶ 1; DX 2- DX 10. This opinion also will refer to the "Reagan software," which covered 811 of the commodities traded by MasterSuite and more. Tr. 22, 28.

"day-to-day manag[ing]," the solicitation of customers, and the review of R&W's advertisements and promotional materials. Ans. ¶ 3; Tr. 139; DX 20, at 43 (deposition testimony of Reagan).[5] None of the respondents has ever been registered with the Commission in any capacity. Ans. ¶¶ 1-3.

B. The R&W Computer Software

The R&W computerized trading systems are based on mathematical formulas that Reagan developed through analyzing historical commodity futures trading data. Tr. 102, 105. According to Reagan, the predictive power of "fundamentals," (e.g., "inflation," "deflation," "recession," and "interest rates") is inferior to the "discernment of abstract mathematical trends." Tr. 131-33. Reagan believes that a successful trading system should be based on the only "three constants" of the commodities markets: "that there's an open, that there's a close, and that history repeats itself." Tr. 105. He asserts that commodity

[5]Reagan and Worsham stipulated that they "directly controlled" R&W within the meaning of Section 13(b) of the Act.

markets behave in seven-year cycles, from which price trends can be extrapolated to predict future price movements. Tr.131.

Using this theory, Reagan developed six different formulas (applicable to 26 different commodities) that purportedly identify exploitable price trends. DX 20, at 50.[6] With the technical assistance of Dr. Steve Corley. Reagan developed the R&W computerized trend-trading systems

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[6]Testimony concerning Reagan's technical skill to develop such a program was elicited at the hearing and at Reagan's deposition. Reagan testified that his relevant education consisted of a high school degree and a program of "self-educat[ion]" consisting of reading financial newspapers. Tr. 103; DX 20, at 40. Reagan's futures industry experience is limited to sales positions at First Arbitrage Corporation, an "independent agency for Dean Witter Reynolds," and First Commodity Corporation of Boston. Tr. 103, 140. Although certain R&W's promotional materials describe Reagan as being a well-seasoned commodities trader with an excellent profits track record," DX 18, Reagan admitted that he has never had a futures account, has never attempted to open a futures account, and has never traded futures. Tr. 141- 42.

which incorporate Reagan's mathematical formulas. Tr. 106; DX 20, at 34. The computer software generates signals to buy, sell, and place stop orders when the mathematical formulas identify the occurrence of certain price trends. Tr. 14, 101; Ans. ¶¶ 1, 4.

To operate the R&W trading system, a user must first obtain market data. which can be downloaded using a CSI software package called "Quiktrieve." Tr. 14, 28-29, 108-09. At the end of each trading day, Quiktrieve enables a user to download the opening price, the high price, the low price, and the closing price for all commodity futures. Tr. 108; DX 20, at 51, 58.[7] Once data is downloaded and distributed to the appropriate computer directories, the user activates a so-called "trading platform" to analyze the data. Tr. 107-08. The trading platform used by R&W was developed by Omega, an entity distinct from R&W.[8] The Omega trading platform allows data

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[7]To use R&W's system, a user must obtain price information after the end of each trading day and before trading commences on the following trading day.

[8]R&W has used several different Omega trading platforms, including "System Writer" and "Supercharts."

and signals to be presented in a readable format, including information concerning the status of open positions and active orders. See DX-20, Exhs. 7, 10.[9]

According to Reagan, Omega's trading platforms contain various trading systems that have been developed by Omega and other outside entities. DX 20, at 57. R&W's software is designed to operate as a distinct trading formula within an Omega trading Platform. Id. at 57-58. With an R&W trading system installed, Quiktrieve will analyze downloaded market data and display on the computer monitor any trading signals that are generated by the R&W algorithms. Id.

[9]A buyer of the R&W software receives the appropriate Omega trading platform along with CSI's "Quiktrieve." Tr. 106-08.

Specifically, the trading signals will indicate that a user should buy or sell a specific commodity futures contract. DX 20, at 47, 58. The signals do not indicate the price at which contracts should be bought or sold; rather, signals direct the user to buy, or sell, regardless of price. Tr. 116; DX 20, at 60, 62. The day after a trading signal is generated, the R&W system will reflect that the average price of the opening range was the price obtained for the recommended position. DX 20, at 117-18 & Exh. 7. Signals directing the user to place an order are accompanied by signals to place a stop order for the same futures contract. DX 20, at 60.[10]

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[10]DX 20, at 60-Apparently stop order signals (which include specific prices) are generated either during or after the day a trading signal is followed, depending on which Omega trading platform is used. 62. Omega System Writer Plus can calculate the stop order price the day a trading signal is followed. Id. Omega Supercharts, however, will not calculate the stop order price until after the trading day is complete. With Supercharts, in order to accompany an order to buy or sell a futures contract with a stop order, a user has to "manually in [his] head" compute the appropriate stop order price. DX 20, at 61. Apparently, Omega trading platforms automatically compute a stop

Trading signals always direct an action to be taken "'at the open." Tr. 14, 92-93, 116.

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order price using the market's opening price, which is downloaded using Quiktrieve.

Signals are generated by the R&W software only when price trends satisfy certain parameters. Tr. 101. The price trends must be present within a "lookback period," which is a certain number of past days over which the system searches for those trends. Tr. 101, 111. An additional parameter is the "whipsaw filter," which is the. number of days that a trend must continue before the software generates a signal. Tr. 32, 111-12. The R&W software is programmed with default settings for the lookback period and the whipsaw filter. Tr. 29-33, 111-13. However, the user can modify these parameters, as well as the "stops" parameter, which is the price at which the system signals the user to exit a position. Tr. 23, 110-13.[11]

The R&W software will generate signals to trade one contract at a time. DX 20, at 94-96. Reagan estimated that, in one year's time,

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[11]In addition, the R&W software accounts for a "maximum drawdown" amount, using margins set at the exchange minimums. Moreover, profitability figures computed by the R&W software reflect commissions of $50 per round turn trade. DX 20, at 55, 117, 120-21.

MasterSuite generates signals to make approximately 36-40 round turn trades. DX 20, at 108.

C. Promoting and Selling the R&W's Software

R&W, Reagan and Worsham solicited members of the general public to purchase the trading system, primarily through advertisements in publications such as Futures magazine. Compl. & Ans. &¶¶ 5, 6; Tr. 121-22; DX 20, at 42, 70. R&W sent promotional brochures to prospective customers. Tr. 121-23.[12] Although the Futures staff Adesign[ed]" the advertisements that would appear in its publication, Reagan and, to a lesser degree, Worsham, provided the "substance" for, "verified," and had "final approval" of those ads. Tr. 147-49; Ans. ¶¶ 2, 3; DX 20, at 66-70, 90-91.

[12]Although Reagan testified at the hearing on August 13, 1997 that a "tremendous amount of business in this last year, probably 30-40%" was through "word of mouth," Tr. 121, in his previous deposition he stated that "to the best of his knowledge, 100% of [R&W's customers] came [through] Futures magazine." DX 20, at 70-71.

1. The Claims Made

Reagan testified that R&W has advertised monthly in Futures magazine since at least 1993. Tr. 145; see DX 1-5, 9-10 (seven different advertisements appearing in Futures between April 1993 and May 1995). In all of the advertisements, R&W claims that its software has generated spectacular profits. See, e.g., DX 1 ("over six years, this trading system has generated a 284% average net profit for trading D-Mark, B-Pound, S-Franc, and J-Yen"); DX 2, 3 (stating that CurrencyMaster "consistently generates triple digit profits year in and year out, trading only one contract at a time in four leading currencies"), DX 4, 5 (chart purportedly demonstrates how "CurrencyMaster would have made $174,239 in profits on a $20,000 initial investment in just six years"), DX 9 (using TreasuryMaster and EuroMaster to make a $64,050 profit from a $3,300 margin account in just 7 years), DX 10 (using the R&W's Master Suite to turn[ ] a $26,650 trading account into a $610,000 fortune in just 7 years!"). In some

advertisements, R&W claims that it made profits by using the software; in other advertisements, R&W is less clear concerning the beneficiary of the incredible profits.[13] The forcefulness of R&W's claims that the software generated actual trading profits varies among the advertisements.

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[13]Compare DX 1 ("For six years, this trading system has made us a 284% average net profit for trading D-Mark, B-Pound, S-Franc, and J-Yen") (emphasis added) with DX 2, 3 ("There's never been anything like [CurrencyMaster]: A trading system that consistently generates triple-digit profits year in and year out, trading only one contract at a time in four leading currencies"), DX 9 ("The historical performance of [TreasuryMaster and EuroMaster] has been incredible. They took a $3,300 margin account and made a I"64,050 profit in just 7 years-trading just one contract in each of two markets!") and DX 10 ("The R&W Master Suite turned a $26,650 trading account into a $610,000 fortune in just 7 years!").

Those who responded to the advertisements were sent descriptive promotional materials. See DX 6, DX 7, DX 8, DX 18; Tr. 166. These promotional materials made claims that are similar to those contained in R&W's advertisements.[14] R&W used its promotional materials to try to convince prospective customers

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[14]Compare DX 4, 5 (charts which "demonstrate[ ] how CurrencyMaster would have made $174,239 in profits on a $20,000 initial investment in just six years," but which also display data based on "trading account balance[s]", "beginning bank balance[s]," and "ending" or "accumulated" bank balance[s]") (emphasis added) with DX 5 (balance information "taken from Certified trade accounts, traded in real time," and that the "trading results" are "certified."), DX 2, 10 ("certified track record"), and DX 4 (a positive "track record"). See, e.g., DX 6 (boasting that CurrencyMaster produced an 873% profit over a six-year period, and Ahealthy bank balances"), DX 8 (graph showing R&Ws positive "Track Record" and account balance data "taken from Certified trade accounts traded in real time for period 1987-92") and DX 18, at 18 (describing the "certified trading record" of CurrencyMaster, which purportedly generated an "average annual gain of 323% for six consecutive years").

that this software package was not too good to be true":

If Market Master Trading Systems are so great, why are you selling them?

TO MAKE MONEY!!!

We are selling Market Master Trading Systems to increase our own trading capital! We know that the more people trade the same signals (trades), this will make our trades that much better - as well as yours. For instance, suppose you buy IBM stock? Would you not want as many people as possible to also buy IBM stock? That principle applies even more so to commodities.

DX 18 (Q & A sheet); see also DX 7 (purpose of selling CurrencyMaster is to "increase our own trading capital," and "[w]e have the bulk of our money in these four currencies, as well as 22 other commodities which we have also developed systems for and have been trading since 1987"); Tr. 173-74.

In its advertisements and promotional

materials, R&W "guaranteed" a profit. DX 1 - DX 5, DX 7, DX 9, DX 10, DX 18 (at 4, 5, 7, 9, 11, 14, 19, 20). In general, any purchaser of the R&W software was entitled to a refund of 110% of the purchase price if, after ""precisely" following all of the software-generated signals for 12 months, either in the market or just on paper, a profit was not generated. Tr. 119; DX 7, DX 18, at 19; DX 16. According to Reagan, since 1993, "about 11" customers have asked R&W to honor the guarantee. Tr. 119-20.

As of June 17, 1996. R&W's existing customer base consisted of 950 customers. DX 21, ¶ 7; Tr. 190-91. Reagan testified that from April 1993 until March 1996 R&W sold the CurrencyMaster software for as little as $2,500 and as much as $3,995. Tr. 192-93; but see DX 1 (CurrencyMaster sold for $3,495 in April 1993).

2. The Basis and Intent of the Representations

As Reagan explained at the hearing, the trading results set forth in R&W's advertisements and promotional materials were based on simulated

results. Tr. 123, 158-59.[15] None of the respondents maintained an actual trading account, made trading profits in '"real dollars," or maintained real bank account balances with trading profits, Tr. 123, 156, 157, 158, 163-68.[16] In defense of the specific wording used in R&W's advertisements and promotional materials, Reagan testified that the specific examples of profits were in the form of illustrating to people what can be done and was being one, not by me

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[15]The simulated results also allegedly reflected transaction costs ($50/trade). Tr. 124.

[16] Reagan admitted that "neither [he n]or any other principal at R&W, or R&W, experienced any real balance sheet reportable to [the] IRS as a result of any futures trading using this or any other system." Tr. 154-55 Reagan even testified that the bulk of his money was invested "not in the market," but in his computer software business. Tr. 169. Furthermore, in a written declaration, expert witness Daniel Driscoll declared that Worsham testified in his deposition that he never traded futures until he opened an account in May 1994. which would be at a point after the period of profitability described in the R&W advertisements and promotional materials. DX 22, at 3.

in the market, but by other clients, and that the system actually did it on computer and for other people." Tr. 167-68. The advertisements and promotional materials that contained data from "certified trade accounts" allegedly reflected Reagan's affirmation that this information derived from the experiences of actual R&W customers. Tr. 160-63 (Reagan explaining that the purpose behind using the word "certified" was to "[l]end credibility" and "[t]o just be more emphatic that these representations are true").

In further defense of the representations made in the promotional materials, Reagan emphasized that the simulated results were not curve fitted." Reagan allegedly analyzed historical trading data for a seven year period to uncover price trends. Reagan claimed that the results reported in R&W's promotions were based only on the existing parameters in the software and were not aided with the benefit of hindsight. Tr. 125-34.[17]

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[17]However, Otten, who traded the R&W system for himself and clients, see infra, testified that Reagan and he "spoke about comparing trades and initially working some of the bugs out of the system." Tr. 16.

When asked about R&W's advertised purpose for selling the system ("to increase our own trading capital"), Reagan conceded that this language was used "to give people the impression that [someone at R&W or R&W itself,] was actually trading," but that he had later "modified this ['oversight'] because it wasn't so." Tr. 175; DX 7.

D. Actual Use of the R&W's Software

The Division presented two witnesses who used R&W's software. Thomas Otten ("Otten"), a registered CTA who trades for himself as well as for clients, has been a stockbroker and an associated person of Prudential Securities since 1989, and has worked in the commodities industry since 1978. Tr. 9-11. Otten became acquainted with Reagan in 1993 when Otten purchased a service that Reagan was then advertising, which consisted of Reagan's "faxing out [futures] trades on a daily basis." Tr. 12. Within a few months, Reagan told Otten that he wanted to discontinue the fax service and sell a computer software trading system. Tr. 13. Otten bought the program and planned to use the Reagan software for himself and, if it proved to be

successful, for clients. Tr.14-15. Otten and Reagan negotiated to pay the purchase price over time out of the commissions that were earned for each signal that was followed at the rate of $5 per trade. Tr. 13-15. Otten also contracted to act as a reference in support of the system if he "liked the program." Tr. 16.

At some point in 1993, Otten began trading the signals generated by the Reagan software for clients, and Reagan began referring potential customers to Otten. Id. at 16- 17. Otten developed two sets of clients: clients for whom he traded the Reagan software, and clients who had purchased their own R&W software.[18] For clients referred to him by Reagan, Otten would not deviate from the signals generated by the R&W software; for the non-referred clients, Otten would use the Reagan software as a

[18]Otten agreed not to trade for clients who were referred to Otten by Reagan unless they had purchased their own software package. Tr.19. In contrast, Otten was not obliged to refrain from trading the Reagan software for clients whom Otten solicited independently. Tr. 19-20.

guide, with some modifications from the default settings and with the discretion not to follow the generated signals. Tr. 21-22, 30-31, 35-37.[19]

[19]Over time, some of the referred customers "decided to [trade] differently" than in accordance with the signals generated by the R&W software. Tr.37.

Otten answered questions from prospective customers about his own experience with the software, the volatility of the system, and the returns that it generated. Tr. 18-19. Otten, who has acted as a reference since 1993, would inform prospective purchasers who were referred to him that "yes, he [liked the software], or [he] wouldn't be trading it" and that "it was successful." Tr. 17-18.[20] Otten also would represent that .the signals could create periods of "substantial drawdowns" and that "it takes more money than [R&W] claim[s] it takes to [trade the software] comfortably." Tr. 18-19. Otten once compared the results that he achieved in actually trading

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[20]The testimony is ambiguous concerning whether Otten would inform referrals about his experience with the Reagan software, the R&W software, or both. Otten traded the "Reagan software" for some clients and the "R&W software" for other clients. Tr.17-18. Furthermore, the record seems to indicate that, for the most part, prospective customers contacted R&W upon seeing the phone number listed in an R&W promotion. Those advertisements and promotions in the record appear to promote only the R&W software rather than the Reagan software used by Otten.

MasterSuite for clients with the results from the same time period that were promoted by R&W in an advertisement. Tr. 23-24. Otten testified that the results he actually achieved trading "the entire MasterSuite" were "substantial[ly]" lower than the advertised gains and estimated the discrepancy at $30,000 for that one year period. Tr. 24-26, 48. Nevertheless, Otten testified that he found the "R&W system... more consistently profitable [than other systems he's tried]." Tr. 40.

John Cullen ("Cullen"), the second witness, has been a registered associated person for J.C. Bradford & Company, Jackson, Mississippi, since approximately 1991. Before working with J.C. Bradford, Cullen worked in the securities business since 1972 with entities such as Merrill Lynch, Dean Witter, and Prudential. Tr. 81-82. After a previous business relationship with Cullen in the mid-to-late 1980's, Reagan contacted Cullen in 1992 or 1993 after R&W was established. Tr. 87. Reagan referred certain purchasers of the R&W software to Cullen, who solicited these individuals to open accounts designed to trade according to the signals, Tr. 87-91. Cullen also independently solicited

customers to open accounts that would use the signals generated by the R&W software as guidelines for trading.[21] Tr. 88.

[21]When Cullen first began this business arrangement, he did not have his own version of the R&W software; instead, he received information about the signals directly from Reagan and/or Cullen's customers. Tr. 88-89.

Cullen testified that he and his customers would not uniformly follow the R&W signals.[22] Tr. 92-93, 97, Cullen opined that the execution of the R&W signals -- which typically direct trades to occur at the opening of the day's trading -- can be risky if, for example, government reports that affect market prices are due that same day. Tr. 92- 93. Cullen also explained how his use of the R&W signals sometimes resulted in trading losses. Tr. 93-95 (because of the effects of overnight trading and other post-close market factors on market price, computer signals generated by activity at the close of one day can direct trades that are substantially out-of-sync with actual prices), 95-96 (because the signals generated by the trading system may take existing positions into account, new users of the software can encounter immediate losses).

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[22]Qualifying his discretionary approach, Cullen conceded that "[i]n some cases [ignoring the R&W signals] benefit[ted] the client, [and in] some cases it didn't." Tr. 93.

E. Expert Opinion Concerning the R&W Claims

The Division presented the sworn declaration of its expert witness, Daniel Driscoll ("Driscoll").[23] Tr. 50; DX 22. According to Driscoll, "[i]t has long been recognized by regulators and market participants alike that hypothetical trading results have many inherent limitations":

> [T]here are many material distinctions

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[23]Driscoll has been the Vice President of Compliance for the National Futures Association ("NFA") for 15 years, with responsibility for the management of all audits and investigations of NFA members, including those involving fraud and registration deficiencies. DX 22, at 1. To prepare his expert opinion, Driscoll reviewed the deposition testimony of both Reagan and Worsham, "[c]opies of various advertisements and other promotional material used by R&W to promote its computer trading systems (DX 1 through DX 10), the complaint, the answer, and "various customer questionnaires." The Division entered neither the customer questionnaires nor the Worsham deposition into evidence. The ALJ struck Part 5 of Driscoll's expert testimony (regarding whether R&W should register as a CTA) from the record. Tr. 51.

> between actual transactions and those that are not executed in the market. For instance, there can be no assurance that a customer following R&W's signals would have been able to execute the trades at the prices depicted in the performance summaries. ...Such performance results simply can not completely account for the impact of risk factors, including the ability of a customer or the advisor to withstand losses or to adhere to a particular trading program when confronted with a losing trade or series of losing trades.

DX 22, at 6-7. In Driscoll's opinion, simulated trades can in no way be considered to be actual

transactions because they were not "real transaction[s] in the market by. .. somebody using the system" after the system has been created.[24] Tr. 61, 70. However, Driscoll conceded that hypothetical trading "going forward in time" could be used to test the predictive power of a system. Tr. 75-76.

F. Nonregistration as a CTA and Refusal to Produce Records

The parties stipulated that a CFTC auditor advised Worsham during a February 1994 walk-in inspection of the offices of R&W that he was trying to determine "why R&W was not registered with the Commission as a CTA." Stipulation at 1-2. At that time and at a subsequent walk-in inspection, the CFTC auditors also requested R&W to produce records supporting "a futures trading track record contained in advertisements R&W had placed in Futures magazine." Id. at 2. Although R&W initially agreed to comply with the investigator's request, the company subsequently declined to

[24]Driscoll also opined that even actual results would not be an "assurance" that a customer could have achieved similar results. Tr. 64, 66-67.

produce any records. Id.; DX 14 (Worsham explaining that since R&W is a "privately held company. ..[,] all of our records [are] private and confidential"). Furthermore, Worsham declined to register R&W as a CTA, explaining that "system development is [R&W's] sole business." DX 14, at 1. Reagan also testified that he believed that R&W did not need to register as a CTA, based on his independent advice from his counsel that entities similar in nature to R&W were not registered. Tr. 134-35.

III. Initial Decision

After receiving post-hearing submissions, the ALJ issued his initial decision. In re R&W [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,193 at 45,714 (ALJ Dec. 1, 1997) ("I.D."). The ALJ found that respondents' activities fell within the plain language of the statutory definition of a CTA. I.D. at 45,730 ("The very purpose of these [computerized trading] programs was to 'advise[ ] others' 'as to the value or advisability of trading in' futures contracts."). As a result, the ALJ found the respondents liable for failure to register as CTAs, in violation of 4m(1) of the Act. Although respondents contended that

such an interpretation violates the First Amendment, the ALJ did not attempt to resolve this constitutional issue. Instead, the ALJ wrote that he was bound by a previous determination of the Commission to leave constitutional challenges to Section 1a(5) of the Act to the United States courts of appeals. Id. at 45, 730.

The ALJ also held that respondents violated the antifraud provisions of the Act, Section 4b(a)(i) and (iii), 7 U.S.C. §6b(a)(i) and (iii). The ALJ found that respondents "intentional[ly]" made "blatantly false" representations in their advertisements and promotional materials for the R&W computerized trading systems. Id. at 45,725-26. Explaining that "claims intended to substantiate representations of increased profit and reduced risk" are important to an investor considering an investment decision, the ALJ concluded that respondents' failure to explain that its trading results were not reached through actual trading was "material." Id. at 45,726-27. Moreover, the ALJ found that respondents' conduct satisfied the "in connection with" requirement of Section 4b(a), stating that the "connection between respondents' solicitations and transactions in futures is 'very close and substantial.'" Id. at 45,725.

Having found that respondents were CTAs, the ALJ found that the same circumstances that warranted a finding of liability for Section 4b(a) fraud similarly justified finding Section 4o(1) fraud. I.D. at 45,729. Moreover, the ALJ found that the respondents violated Commission Rule 4.41, by failing to include the disclosure required by Rule 4.41(b) regarding the use of hypothetical as opposed to real trading in their advertisements. I.D. at n.79.

Although the ALJ found that R&W acted as a CTA, the ALJ declined to find that it violated Section 4n(3)(A) of the Act. The ALJ found controlling the "plain meaning" of Section 4n(3)(A), which applies only to "registered" CTAs, "not unregistered ones such as R&W." Id. at 45, 731. The ALJ held that because other statutory provisions governing CTAs did not apply expressly to "registered" CTAs, the existence of such a requirement in Section 4n(3)(A) is significant and meaningful. However, the ALJ found no such problem with finding that R&W violated the Commission's regulatory recordkeeping requirements, Commission Rules 4.33 and 1.31, because they apply to "each CTA registered or

required to be registered under the Act." Id. Because respondents stipulated that they maintained R&W's business records at Reagan's home, and that R&W refused to produce its records for inspection, the ALJ found that such facts demonstrated that R&W violated the retention and production requirements. I.D. at 45,731-32; see Commission Rules 4.33 (requiring CTA to retain records at its Amain business office") and 1.31 (all books and records shall be "open to inspection"); Stipulation at 2.

In addition to finding Reagan and the Worsham estate individually liable for violations of Sections 4b(a)(i), 4b(a)(iii), 4m(1), 4o, and Commission Rule 4.41, the ALJ held Reagan and the Worsham estate secondarily liable as aiders and abettors under Section 13(a) of the Act and as controlling persons under Section 13(b) of the Act for R&W's primary violations. I.D. at 45,723 n.51, 44,729 n.79, 45,730 n.89, 45,732 n.96.

Upon making the liability determinations, the ALJ imposed sanctions. Finding that Reagan and R&W were likely to repeat their wrongful conduct, the ALJ ordered that they cease and desist from violating those provision of the Act and the

Commission's regulations for which they were found liable. I.D. at 45,732. In addition, the ALJ imposed civil monetary penalties of $7,125,000 to be paid jointly and severally by Reagan and R&W. Employing a "gains-based" approach, the ALJ considered the gains received by the respondents to be comprised of the revenue earned from selling the computerized trading systems. Drawing from the record that R&W sold the R&W software to at least 950 customers at a minimum price of $2,500 for the R&W software, the ALJ calculated that respondents received at a minimum $2,375,000 in revenues. In addition, the ALJ described this figure as a good approximation of customer losses, since "it is reasonable to assume traders would not have purchased the R&W systems but for the misrepresentations made by respondents." I.D. at 45,735.[25] Finding that the gravity of respondents'

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[25]The ALJ conceded that his estimate of the gains reflected only a gross figure and that the number of customers was estimated as of a time period three months after the time period covered by the complaint. Id. at n.122. However, the ALJ described his calculation of gains as "an extremely conservative estimate of respondents' ill-gotten gains" because it did not reflect the dramatic rise in the sales

fraud was severe and that a lesser penalty would not adequately serve to generally deter such conduct," the ALJ calculated the civil penalty at triple the monetary gain, pursuant to the statutory multiplier in Section 6(c) of the Act, 7 U.S.C. § 9. The ALJ also ordered a permanent trading ban against Reagan and R&W because he found their actions to represent an inherent threat to the market. Id. at 45,735-36.

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prices or repeat customers. Id.

However, the ALJ declined to order restitution against any of the respondents. Refusing to Aspeculate as to the scope and administration of any sanction in the absence of any omission guidance," id. at 45, 736-37, the ALJ declined to follow the Division's recommendations on restitution.[26] As a result, the ALJ dismissed the complaint as to all matters concerning the Worsham estate.

IV. Appeals to and Motions Before the Commission

A. R&W and Reagan's Appeal

R&W and Reagan filed timely notices of appeal and appeal briefs. First, they contend that the ALJ erroneously found that they acted as CTAs,

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[26]The Division suggested that restitution be calculated by multiplying the maximum sales price charged for an R&W trading system during the time period covered by the complaint ($3,995) by the approximate number of customers (950) to generate a restitution fund of $3,795.250. The Division also proposed in its post-hearing brief that the NFA could serve as the administrator of the Court's restitution award. I.D. at 45,736 & nn. 133-34.

which is the necessary basis of liability under Sections 4m and 4o of the Act, and Commission Rules 4.41 (a), 4.33 and 1.31. R&W and Reagan contend that their business was the selling of "mathematical formulas" and that, as a result, they neither participated in the range of activities covered by the Act's CTA definition, nor "issue[d] analyses or reports concerning" such activities. Resp. Br. at 13. R&W and Reagan, who describe themselves as "publishers of impersonal publications," also argue that the ALJ's conclusion fails to follow Lowe v. SEC, 472 U.S. 181 (1985). Resp. Br. at 14-16 & n.11. In addition to their statutory arguments, R&W and Reagan contend that the ALJ's conclusion "'unconditionally subject[s] purely impersonal publishers to a discretionary licensing system" and unconstitutionally differentiate[s] between different kinds of speakers...in violation of the First Amendment and the Equal Protection Clause." Resp. Br. at 18. For their argument, R&W and Reagan primarily rely on asserted constitutional undercurrents in the Lowe case.

R&W and Reagan also appeal the decisions of the ALJ that they violated Sections 4b and 4o of

the Act. Resp. Br. at 19-41. First, they argue that their advertisements were not misleading because the published trading results allegedly were based on simulated, real-time trading without the benefit of hindsight.[27] Id. at 19. Second, distinguishing their solicitations as being solely related to computer software and arguing that the alleged fraudulent activities took place before any futures transactions were initiated, R&W and Reagan reason that the statutory requirement of Section 4b(a) of the Act that the fraud be "in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery" requires a closer link to commodity futures than was present here. Id. at

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[27]R&W and Reagan contend that any difference between an actual trading account and their simulated account was not material, "in the absence of a showing that the trading results would have been different for the two." Resp. Br. at 19-20. R&W and Reagan also contend that the disclosures mandated by Rule 4.41(b)(1)(i), which describe the "inherent limitations" of hypothetical trading results, present risks that are not material to a prospective customer unless proved to exist with respect to the particular system. Id. at 20-23.

29, 31-32. Third, R&W and Reagan summarily assert that the Division did not prove the requisite scienter to establish a violation of the antifraud provisions. Id. at 40. Last, claiming that statements in their advertisements "clearly impl[y] appreciable risk," R&W and Reagan contend that the ALJ .'mischaracterizes" respondents' advertisements. Id. at 27-28. R&W and Reagan do not make any arguments concerning the ALJ's findings that they violated Commission Rule 4.41, although we construe the arguments pertaining to Sections 4b and 4o also to apply to the

imposition of liability under Commission Rule 4.41.[28]

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[28]While R&W and Reagan phrase their arguments in multiple variations, the gist of their contentions concerning the ALJ's findings of fraud is captured by this summary. See Resp. Br. at 19-41. We note that R&W and Reagan also argue that the ALJ's decision was predicated impermissibly on a finding that the computer system was not effective. Id. at 24-26. However, because we make no finding regarding the effectiveness of the trading system (as discussed below), R&W and Reagan's argument ceases to have relevance. R&W and Reagan's other arguments on the issue of liability under Section 4b are meritless. See id. at 40 (contending that the Division did not prove the "identity of 'such other person'" under Section 4b(a)(i) and (iii)); 40-41 (contending that solicitation fraud is governed by Section 4n of the Act, rather than 4b).

R&W also appeals the ALJ's findings that it violated recordkeeping and production regulations. Primarily, R&W contends that Commission Rules 4.33 and 1.31 do not apply to it because it was not a CTA. Furthermore, while R&W agrees with the ALJ's decision that Section 4n(3)(A) applies only to registered CTAs, it contends that the ALJ did not properly extend that principle to Commission Rules 4.33 and 1.31. According to R&W and Reagan, because Section 4n(3)(A) is limited to registered CTAs, the Commission's authority to adopt recordkeeping regulations was similarly limited. Resp. Br. at 42.[29]

As for sanctions, R&W and Reagan argue that the civil monetary penalties imposed by the ALJ are too severe in light of their contentions that: (1) the Commission has never before held that providers of impersonalized services are CTAs; (2)

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[29]The Worsham estate did not appeal from the initial decision. Due to the absence of an appeal and our decision that an award of restitution is not appropriate, we summarily affirm those aspects of the initial decision concerning the Worsham estate's liability for violating the CEA and the Commission's regulations.

the Commission has never imposed penalties under Section 4b(a) where the connection between the fraud and the commodities transactions was "incidental"; and (3) the fraud does not relate to actual customer losses in commodities transactions. R&W and Reagan also complain that in assessing civil monetary penalties, the ALJ wrongly failed to conduct an analysis of the "gravity of the violation," as set forth in In re Rousso, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,133 at 45,310 (CFTC Aug .20, 1997), aff'd, No.97-4232 (2d Cir. Mar. 11, 1998), and In re Grossfeld, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,921 at 44,467-68 (CFTC Dec. 10, 1996), aff'd in part and appeal dismissed in part, 137 F.3d 1300 (11th Cir. 1998), which R&W and Reagan contend would have resulted in a finding that the gravity of their actions was slight. Resp. Br. at 43-48. Concerning the imposition of trading bans, R&W and Reagan argue that the alleged violations had no bearing on the "integrity" of the futures markets, especially since none of the respondents has ever traded. Id. at 50. Moreover, R&W and Reagan argue that the imposition of a permanent ban is contrary to the Commission's general unwillingness to impose such a sanction.

In response, the Division supports the ALJ's conclusion that respondents' activities are covered by the Act's CTA definition. Div. Answ. Br. at 12, 17 (citing CFTC v. AVCO Fin. Corp. [Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,173 at 45,580 (S.D.N.Y. 1997)). The Division claims that R&W and Reagan's argument based on reflects a narrow reading of the definition of CTA that was rejected by the Commission in In re Armstrong, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,657 (CFTC Feb. 8, 1993), rev'd on other grounds, 12 F.3d 401 (3d Cir. 1993), and that is inconsistent with the broad construction called for by the CEA and its legislative history. Div. Answ. Br. at 15-17. Moreover, even if which interpreted the Investment Advisers Act of 1940 were persuasive authority, the Division argues that the respondents are distinguishable from the "impersonal" publishers involved in Id. at 20-21. In response to R&W and Reagan's constitutional arguments, the Division suggests that the Commission normally declines to address such questions. Div. Answ. Br. at 22 n.12. It also contends that, in any event, the Commission

should uphold the CEA's registration requirement as a permissible licensing scheme that is rationally related to a CTA's fitness to act. Id. at 23-25.

The Division argues that the ALJ correctly decided that respondents violated the antifraud provisions of the Act. Div. Answ. Br. at 29-42. It maintains that the difference between a hypothetical trading account and an actual account is a material distinction to a reasonable investor, regardless of whether the actual results would have differed from the simulated results. Id. at 33-34. As a result, the Division argues that certain claims made in the R&W advertisements and promotional materials were "blatantly false" because respondents concededly never traded real contracts pursuant to the system. Id. at 30-34. In addition, the Division argues that respondents' activities clearly were "in connection with" commodity futures trading, within the meaning of Section 4b(a) of the Act. Echoing the initial decision, the Division describes the link between respondents' activities and futures trading as "close and substantial" because the systems were marketed "as a vehicle for making one's fortune in futures speculation."

Id. at 36. Moreover, the Division disputes R&W and Reagan's claims that federal case law concerning this language requires either actual trading or the opening of a discretionary trading account before liability for fraud attaches. Id. at 36, 41.

As for the recordkeeping and production violations, the Division argues that R&W was a CTA and that Commission Rules 4.33 and 1.31 are authorized by Section 8a(5) of the Act. The Division further contends that Commission Rules 4.33 and 1.31 are authorized by Section 4n(3)(A), because it would be anomalous to read that provision as applying only to registered CTAs.

In response to R&W and Reagan's sanctions arguments, the Division contends that the ALJ's civil penalty determination reflects a "reasoned analysis" of relevant factors, was sufficiently high to achieve the purpose of deterrence, and fairly reflects the gravity of the offense. Div. Answ. Br. at 47, 50. The Division also supports the ALJ's imposition of a permanent trading ban on Reagan and R&W because their conduct reflected a pattern of intentional and highly damaging

conduct. Id. at 51-52.[30]

B. The Division's Appeal

The Division also filed a timely notice of appeal and appeal brief which addresses only the ALJ's failure to award restitution. The Division argues that ALJs are fully capable of awarding restitution in the absence of Commission rulemaking on the topic and that the factors recently identified by the Commission as relevant to an award of restitution weigh in favor of such an award. Div. Br. at 2, 15-18 (citing In re Staryk, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,206 (CFTC Dec. 18, 1997)). The Division asks that we reverse and remand the ALJ's decision on restitution and instruct him to consider the appropriateness of restitution in light of the guidance provided in Staryk. Id. at 19-20.

[30]The Division also supports the ALJ's imposition of a cease and desist order. Id. at 47 n.25.

In response, the respondents, including the Worsham estate, argue that an award of restitution is not appropriate. They contend that no customers were harmed because they bought an excellent trading system." Resp. Answ. Br. at 16. They argue that the record demonstrates that the customers who followed the system did not lose money and that the Division's own fact witnesses testified that they like the system. Id. at 17. The respondents also argue that the Staryk factors weigh against such an award.[31] Should the Commission remand the case to the ALJ, the respondents contend that it needs to be remanded for all purposes, including a

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[31]First, they contend that establishing that their conduct proximately caused the customers' harm would be difficult, given the number of individual customers involved. Moreover, they contend that the Division's analogy to the abbreviated method of proving proximate cause in Federal Trade Commission cases is inappropriate because in the CFTC context "proximate cause" is not a statutory requirement of a restitution award. Id. at 17. In addition, they contend that an award of restitution would be "an empty gesture of goodwill" because there is no evidence of the respondents' ability to pay such an award. Id. at 17-18.

reassessment of all sanctions and liability issues. Id. at 19.[32] Furthermore, the respondents request that the Commission not order a bifurcated procedure similar to the one used in Staryk in order to support "decisional efficiency" and to avoid imposing financial burdens on those with limited resources. Id.

The Worsham estate further argues in response to the Division's appeal brief that the initial decision is impermissibly tainted by the alleged bias of the ALJ. The gist of the Worsham estate's argument is that the initial decision demonstrates the ALJ's belief that technical trading systems could never result in a fair value for the consumers who buy such systems. Resp. Answ. Br. at 2-6. As a result, the Worsham estate argues that respondents did not have a fair hearing, that the ALJ did not decide the case on the issues before him, and that the ALJ improperly rejected the testimony of the Division

[32]For example, the respondents argue that remanding the case to determine whether their conduct proximately caused the harm of the customers would require testimony relevant to the materiality of the representations made in R&W's advertisements.

witnesses that supported the respondents' case. Id. at 7-10.

C. Motions Requesting Procedural Actions

In addition to the issues presented on appeal through the briefs, we also have before us several motions requesting that we take various procedural actions. The Worsham estate has requested that we hold oral argument. In addition, respondents have requested that we reopen the hearing to receive more evidence and that we permit them to file one such exhibit under seal. See Resp'ts' Mot. Pursuant to Rule 10.107 to Reopen the Hearing; Resp'ts' Supp. Mem. in Support of Their Mot. for Leave to Reopen the Hearing ("Resp'ts' Supp. Mem."); Resp'ts' Mot. for Order Permitting a Filing Under Seal; Resp'ts' Resp. to Division of Enforcement's Unilateral Supp. to R. on Appeal. The Division opposes the respondents' request to reopen the hearing and requests that we strike respondents' Supplemental Memorandum. Mem. in Opp. to Resp'ts' Mot. to Reopen the Hr'g; Div. Mot. to Strike. Respondents also have filed a

Memorandum in Opposition to the Division's Motion to Strike.[33]

[33]The parties also have requested that two recent rulings in CFTC v. AVCO Fin. Corp., No.97 Civ. 3119 (S.D.N.Y. June 29 and Aug 31, 1998), be considered a part of the record on appeal. Although we will not consider these authorities to be part of the record, we treat them as pertinent.

DISCUSSION

I. Procedural Issues

Respondents seek to reopen the administrative hearing in order to introduce evidence supporting the purported efficacy of the R&W's trading system and the truthfulness of their claims that the system successfully simulated the published results.[34] Respondents point out that the Division's theory of the fraudulent conduct (discussed infra) was not dependent on a finding that the R&W's trading system would be ineffective in generating profits. Compl. ¶¶ 8-18; Div. Prehearing Mem. at 14-16. However, respondents contend (i) that the ALJ found that

[34] The evidence that respondents now seek to introduce includes testimony of Dr. Steve Corley (the technical developer of the R&W trading systems), expert testimony concerning the effectiveness of the R&W trading systems, and customer statements.

the trading system was ineffective and that respondents did not successfully simulate the published results and (ii) that the ALJ impermissibly relied on these findings when making his liability determinations because they were made without supporting evidence and without proper notice to respondents as to the materiality of these issues. Resp. Br. 24-28; Mot. to Reopen the Hr'g at 8-14.

Commission Rule 10.107, 17 C.F.R. §10.107, provides that an application for leave to introduce additional evidence must demonstrate that the evidence is "material" and that there were "reasonable grounds for failure to adduce such evidence at the hearing." Respondents' request to reopen the hearing does not clear the latter hurdle. Respondents' claim of lack of notice is specious: they clearly believed that the efficacy of the system was an issue in the case and argued that the software was effective. Resp. Post-Hearing Mem. at 5 n.2, 6-7, 35. Respondents' failure to introduce evidence supporting these arguments was the result of their own tactical decision. See In Re Armstrong [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,332 at 42,610 (CFTC Mar. 10, 1995),

aff'd, 77 F.3d 461 (3d Cir. 1996), cert. denied, 517 U.S. 1244 (CCH) ¶25,373 at ¶39,261 (CFTC Aug. 27, 1992).[35]

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[35]For purposes of determining liability for fraud, we agree with both parties that evidence of efficacy is irrelevant in this case. The Division's allegation of fraudulent solicitation is primarily that R&W misrepresented its advertised performance results as being supported by actual trading results. This allegation requires neither a showing that the R&W computerized trading software did not work effectively for customers nor a finding that R&W successfully simulated their advertised results. Rather, the fraudulent nature of the representations made in R&W's advertisements is judged only by examining whether there were actual trading results supporting those representations, and whether the distinction between simulated results and actual trading results is material to the reasonable customer.

Contrary to respondents' argument, the ALJ did not conclude otherwise. In making his Section 4b liability determinations, the ALJ relied not on a finding that the computer software was ineffective, see I.D. at 45, 723-29, but on determinations that the representations claiming that the results were backed by ... extensive, systematic actual trading" were misleading and that R&W's "false claims of proven success in actual trading" violated the Act. Moreover, the ALJ stated that respondents' belief in the efficacy of their system was immaterial to the question of whether they made fraudulent solicitations, even as to the element of scienter. See id.. at 45, 726 n.67. Therefore,

although the ALJ made no attempt to conceal his belief that R&W's trading systems could not be as effective as respondents claimed them to be (see I.D. at 45,722, 45,726 n.67, 45,727 n.75) and that the respondents never even simulated the published results in their simulation (id. at 45, 723), his various statements to that effect were dicta.

In addition, the June 29, 1998 memorandum order in AVCO is not inconsistent with our position in this case that evidence of efficacy is irrelevant for purposes of determining R&W and Reagan's liability for fraud in AVCO, the Southern District of New York considered testimony from customers about their "substantial losses" incurred using a computerized trading system called "Recurrence." The district court considered such evidence of ineffectiveness to demonstrate that AVCO's claims of extraordinary profitability and low risk were false. AVCO, No.97 Civ. 3119, at 20 (S.D.N.Y. June 29, 1998). We do not believe that it was necessary for the judge in to rely on customer testimony to find that commodity futures trading is not a "low-risk, high profit venture." Id. But that is beside the point. The district court additionally found that "the representations that Recurrence's performance history was based on actual trading were false and fraudulent," without relying on the inefficacy of Recurrence. Id. Nothing in suggests that proof of an effective product would have caused the district court to conclude otherwise.

Moreover, the efficacy of the R&W trading system and the extent to which R&W successfully simulated the advertised trading results were relevant as mitigating evidence in assessing sanctions, and clearly, the respondents recognized this. See Resp. Br. at 46, Resp. Post-Hearing Mem. at 35 (arguing that civil monetary penalties should be lessened due to the fact that customers "got fair value..: trading systems that worked."). Fraudulent representations that a computerized trading system has generated actual trading profits are less egregious when there is credible proof that the system actually performs as promised. This is not to imply that such misrepresentations are not in violation of the Act; rather, such evidence is relevant when determining the types and degree of sanctions that should be imposed.

Evidence of the efficacy of R&W's trading system was not relevant to the ALJ's findings of liability. Tothe extent such evidence was relevant to mitigate the violations, respondents do not offer reasonable grounds for their failure to offer relevant evidence at the hearing. Therefore, we

deny respondents' request to reopen the hearing.[36] None of the exhibits to respondents' motion to reopen the hearing is part of the record on appeal, and we further deny the respondents' request to file an additional exhibit under seal.[37]

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[36]Respondents also contend that reopening the hearing is necessary because the initial decision incorrectly refers to R&W Technical Services, Ltd. as "R&W Technical Services, Inc." Supp. Mem. at 1-3. This minor error in the initial decision does not require the drastic step of reopening the hearing. As part of our de novo review of this case, we note that the record clearly refers to R&W Technical Services, "Ltd." Ans at 1, ¶ 1. Because the initial decision is not the final decision of the Commission in this case, ill Commission Rules 10.84(c) and 10.104, 17 C.F.R. §10.84(c) and 10.104 (1998), our accurate references to "R&W Technical Services, Ltd." in this opinion and order correct the technical error.

[37]We deny the Worsham estate's request for oral argument and the Division's Motion to Strike.

II. Substantive Issues

A. Whether R&W, Reagan and Worsham Are CTAs

1. Respondents' activities fall within the plain meaning of Section 1a(5) of the Act

Turning to the substantive issues in this case, we first address whether respondents acted as CTAs within the meaning of Section 1a(5) of the Act. Subject to certain exclusions, a "CTA" is any person who

(i) for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in -

(I) any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market;

...

or

(ii) for compensation or profit, and as part of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i).

Section 1a(5)(A) of the Act, 7 U.S.C. §1a(5)(A) (1994). Excluded from this definition is any "publisher or producer of any print or electronic data of general and regular dissemination, including its employees" (the "publisher exclusion"). Section 1a(5)(B) of the Act. This statutory exclusion, however, is operative only if the furnishing of such services by such persons is "solely incidental to the conduct of their business or profession." Section 1a(5)(C) of the Act. We hold that the respondents acted as CTAs and affirm that finding of the ALJ.

In interpreting the breadth of a statutory provision, our primary goal is to determine and give effect to the intention of the legislature. Damiani v. Futures Inv. Co., [1980-1982 Transfer

Binder] Comm. Fut. L. Rep. (CCH) ¶21,097 at 24,416 (CFTC Sept. 3, 1980). "Generally, one should look first to the words of the statute for guidance then to other relevant secondary aids such as other provisions of the statute, the policies and purposes underlying the statutory scheme and legislative history." Id.

R&W's software-generated recommendations fall within the clear statutory definition of CTA. The computerized trading signals provide specific recommended trades indicating which futures contract should be bought or sold, when it should be traded, and where to place a stop order. These trading signals are coupled with respondents' advertisements and promotional materials, which attempt to convince prospective customers that following the trading signals will generate immensely profitable trades in the futures markets. These activities clearly constitute "advising others. ..through publications, writings, or electronic media, as to the value of or the advisability of trading in. ..any contract of sale of a commodity for future delivery." 7 U.S.C. ' 1a(5)(A)(i). Our conclusion is all the more compelling in light of the specific and immediate nature of the R&W trading

signals. The respondents' communications did not contribute to a generalized discussion about the principles of futures trading nor were they a mere source of information. Instead, R&W's trading signals consisted of specific, unexplained recommendations in response to certain market conditions. To be useful these signals were to be utilized promptly as a direct basis for action, inviting customers to rely on the respondents' expertise. Furthermore, because R&W sold its computerized trading systems for at least $2500/unit, its advisory business was "for compensation or profit."

Our holding is reinforced by CFTC v. AVCO Fin. Corp., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,173 (S.D.N.Y. Sept. 29, 1997), appeal pending sub nom, CFTC v. Vartuli, No.98-6280 (2d Cir.). In AVCO, a company developed and marketed computer software that generates specific recommendations to buy and sell adequately alleged that AVCO acted as a CTA under the "plain language of the CEA." Id. at 45,582.[38]

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[38]After buying and installing "Recurrence" (the trading software), AVCO customers purchased a separate service

The only statutory exclusion which could apply-the publisher exclusion -- does not apply for three distinct reasons. First, the R&W software is not something which is of "regular dissemination." The software's unpredictable trading signals are not "published" on a periodic basis. Rather, they are generated as a direct result of price trends occurring in the futures markets. As a result, the dissemination of those

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that supplies current market data. ¶27,173 at 45,580. Using that data, Recurrence would generate specific trading recommendations. AVCO marketed its computer software in various publications, including Futures, as well as through direct mail and phone solicitations. AVCO promoted. Recurrence as a program that would generate highly profitable commodity futures trading advice. Id. AVCO made representations that Recurrence was an "automatic" system, which assigned to the customer only the task of contacting his or her broker to make the recommended trade. In addition, AVCO maintained contact with its customers after the time of purchase. For example, many of AVCO's customers would contact AVCO before following Recurrence's recommendations, "to ensure that AVCO agreed with the recommendations." Id. AVCO also directed customers in need of a broker to one that was "authorized" to trade Recurrence. Id. at 45,581.

trading signals does not qualify as "regular." See Lowe, 472 U.S. at 209 (indicator of "regular" publication is when "there is no indication that [dissemination] ha[s] been timed to specific market activity").

Second, even if we were to view the software package (rather than the trading signals) as the "data" that is disseminated, the R&W's software is not of "general dissemination." A publication is of general dissemination when it is circulated for sale to the general public at large in an open market. Id. at 210. A publication's dissemination would qualify as "general" when its cost, distribution, and availability combine to produce no more than small burdens on access. Here, however, the record demonstrates that R&W limited the availability of its product to a specified number of customers. See, e.g., DX 3 ("Only 500 copies of this powerful new trading system are available to the public, and they're going fast."), DX 4, DX 10. Moreover, the significant cost of its software necessarily limited the numbers of customers and did not allow for "general" dissemination.[39]

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[39]In these respects, this case is clearly distinguishable from

Third, even if R&W's software program fit within the language of the publisher exclusion, that exclusion would be inapplicable because the furnishing of the software is not "solely incidental" to the conduct of R&W's business. In defining "solely incidental," we do not rely on a specific numerical standard or percentage of revenues or business, but rather, consider "the nature of the business and the factual context in which the advisory services are rendered." Armstrong, ¶25,657 at 40,149. Generally, if a

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Lowe. The Supreme Court found the publication in Lowe to be of "general and regular circulation." Notwithstanding the fact that the Lowe Investment and Financial Newsletter was not published according to its advertised semi-monthly timetable, the Court found it to be "regularly. disseminated because there was no indication that dissemination was "timed to specific market activity, or to events affecting or having the ability to affect the securities industry." Id. at 209. Moreover, the number of subscribers to Lowe's newsletter "ranged from 3,000 to 19,000." Id. at 185. Although the two other publications at issue in Lowe had significantly fewer subscribers, there is nothing to suggest that the circulation of those publications was limited, as it is in this case.

publication has a specialized focus upon futures transactions or is largely devoted to futures trading, the commodity trading advice furnished therein will not be considered to be solely incidental to the conduct of the publisher's business. Id. Clearly, the furnishing of futures advisory services was not solely incidental to R&W's business. The R&W software has an exclusive focus on commodity futures trading, and respondents concede that the marketing of these futures trading systems was their only business. Resp. Br. at 2.

2. *Lowe* v. SEC is not controlling

As we have articulated previously, we do not believe that Lowe v. SEC is controlling with respect to the scope of the publisher exclusion in the CEA. Lowe involved an interpretation of Section 202(a)(11)(D) of the Investment Advisers Act of 1940 ("IAA"), a statutory exclusion to the definition of "investment adviser." Lowe, 472 U.S. at 204.[40] In Lowe, the Supreme Court held that

[40]Compare 15 U.S.C. § 80b-2(a)(11)(D)(excluding from the definition of investment adviser the publisher of any bona fide newspaper, news magazine or business or financial

the statutory exclusion covered the newsletter-publisher in that case. In so deciding, the Supreme Court held as a matter of statutory interpretation that where "communications [between publishers of securities investment newsletters and subscribers] remain impersonal and do not develop into the kind of fiduciary, person-to-person relationships that were discussed at length in the legislative history of the [IAA] and that are characteristic of investment adviser-client relationships," Congress did not intend that such publishers of impersonal advice fall within the definition of investment adviser. Id. at 210.[41]

The argument that Lowe should guide us to the proper interpretation of Section 1a(5) of the CEA

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publication of general and regular circulation") with 7 U.S.C. § 1a(5)(B)(iv)(excluding from the definition of CTA "the publisher or producer of any print or electronic data of general and regular dissemination").

[41]In so finding, the Lowe Court held that the SEC could not enjoin the future publication of a semimonthly newsletter containing investment advice and commentary on the basis that the publisher was not registered as an investment adviser. Id. at 203-211.

is unpersuasive. First, involved the scope of the IAA's statutory publisher exclusion, which is an imperfect analogy to the CEA's statutory exclusion. The publisher exclusion in the CEA is available only to those publishers whose investment advice is "solely incidental to the conduct of their business or profession." As such, it is "narrower than the IAA exclusion addressed in Lowe," which is applicable to any business or financial publication of general and regular circulation. AVCO, ¶27,173 at 45,582; Armstrong, ¶25,657 at 40,149. This difference in language is important. The "solely incidental" modifier to the publisher exclusion effectively retains certain publishers -- whose communications are by necessity "impersonal"-- within the definition of CTA. As a result, it suggests that Congress did not intend for "personalized advice" to be a prerequisite to the definition of CTA.

The persuasiveness of Lowe for purposes of interpreting the CEA is further undermined by the statutory scheme of the CEA, which demonstrates that Congress intended to place measures of control over certain advisors offering impersonal advice. Congress included

"publications", "writings", and selling "subscriptions" within 'the listed activities of CTAs. 7 U.S.C. § 6l. Moreover, the recordkeeping provisions of the Act demonstrate that Congress intended to include more than just brokers or individuals with personalized relationships with clients within the statutory definition of CTA, as demonstrated by the reference to subscriber[s]" as among the different types of CTA customers that Congress contemplated. See Section 4n(3)(A), 7 U.S.C. § 6n(3)(A).

In contrast to the legislative history of the IAA., see Lowe, 472 U.S. at 190, 202-04, the legislative history of the CEA provides additional evidence that Congress was not merely concerned with CTAs who provided "personalized" trading advice. The first definition of "CTA" was set forth in the Commodity Futures Trading Commission Act of 1974 (the "1974 Act"). Pub. L. No.93-463, 202, 88 Stat. 1389, 1395 (1974). One Congressional report describes CTAs as individuals who are involved either directly or indirectly in influencing or advising the investment of customers' funds in commodities. This would include any individuals or organizations identified as influencing or

actually investing funds in the commodities markets.

House Subcomm. on Special Small Business Problems of the Permanent Select Committee on Small Business, Report on Small Business Problems Involved in the Marketing of Grain and Other Commodities. H.R. Rep. No.963, 93d Cong., 2d Sess. at 37 (1974) (emphasis added).

In addition, Congress was mindful of the fact that impersonal advice can influence the futures markets and that some governmental oversight of such activities was necessary. In adopting the CTA registration provisions in 1974, Congress articulated its concern with "trading clubs," which consisted of brokerage houses providing impersonal advice to groups of investors. The House Subcommittee on Special Small Business problems stated that "the inherent dangers of such clubs are obvious. If a broker had enough people moving in the same direction with each holding a substantial number of hedged positions, it is obvious that they could substantially distort the market under certain circumstances." H. Rep. No.963, at 55, 68; see also S. Rep. No.93-1131, 93d Cong., 2d Sess. at

18 (1974) (discussing dangers of groups of speculators "acting in concert"); Hearings Before the House Subcomm. on Special Small Business Problems of the Permanent Select Comm. on Small Business, Small Business Problems Involved in the Marketing of Grain and Other Commodities, 93d Cong., 1st Sess. at 328-31 (1973) (testimony of Alex C. Caldwell, Administrator, Commodity Exchange Authority). In short, in contrast to the IAA, both the language and the legislative history of the CEA demonstrate that Congress was concerned not only with protecting individual CTA clients from fraud and overreaching by their personal advisors, but also with protecting the commodities markets from improper influence and abusive practices of unscrupulous advisors.

Moreover, Congress' intent to include impersonal advice within the definition of CTAs is understandable in light of typical advisory practices in the futures industry. Many, if not most, CTAs give advice or manage accounts based on a "trading program" or "trading system" which is "impersonal" and not customer-specific, as recognized in the Commission's regulations. Commission Rules 4.31(a), 4.34(h), 17 C.F.R. "

4.31(a),4.34(h).[42] Commodity trading advice based on market trends or factors, rather than the individual makeup of a customer's portfolio, is the norm:

> Commodity money management's basic and declared premise is that trading in modern commodity markets is a vocation, a line of work best performed not by well-intentioned amateurs, but by full-time professionals armed with trading systems designed to yield a stream of profits over time, constrained by some predetermined degree of downside risk.

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[42]A "trading program" is defined as a program pursuant to which a person (1) directs a client's commodity interest account or (2) guides the client's commodity interest trading by means of a systematic program that recommends specific transactions. Commission Rule 4.10(g), 17 C.F.R. § 4.10(g).

Most such systems are technical rather than fundamental in character. This is to say that they project price movements in light of historical experience, as against forecasting by reference to the underlying conditions of supply and demand for each commodity. Furthermore the great majority of commodity money managers use computer programs to generate the trading signals on which are based the orders to buy or sell. These signals are rarely or never second-guessed by the trading advisor. True, there are a few chartists and fundamentalists who continue to manage other people's money in the

> futures markets, but the technical approach promises by its past performance to be the dominant technique for the foreseeable future.

Leon Rose, "Commodity Money Management," in The Concise Handbook of Futures Markets: Money Management Forecasting and the Markets 19-3 (Perry J. Kaufman, ed.,1986.).

Therefore, for the purposes of defining a CTA, distinctions based on the nature of the contact between the CTA and the customer, as opposed to the nature and purpose of the advice itself, have limited relevance. Computerized trading system software such as that at issue in this case, which automatically generates real-time buy and sell trading signals based on market data, functions in a manner analogous to that of a commodity account manager or a personalized advisor who telephones a customer with specific trading recommendations.

Any attempt to exclude Aimpersonal" advisors would remove from our oversight many of those

who are part of the core group for whom the statute was created. The "personal/impersonal" distinction that the Supreme Court used to interpret the publisher exclusion to the IAA is simply not consistent with the Congressional intent of the CEA. We therefore hold that R&W and Reagan acted as CTAs.

B. Section 4b of the Act: Fraudulent Solicitation

We turn next to whether R&W and Reagan made fraudulent solicitations, in violation of Section 4b of the Act. We conclude that they did, and affirm the decision of the ALJ in this respect.

Section 4b(a), one of the antifraud provisions of the Act, provides that

> It shall be unlawful. ..(2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made, or to be made, for or on behalf of any other

person...

(i) to cheat or defraud or attempt to cheat or defraud such other person;

...

(iii) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract, or in regard to any act of agency performed with respect to such order or contract for such person.

7 U.S.C. §6b(a)(i) and (iii). Misrepresentations can constitute a "means" by which a fraud is committed, provided that respondents' misrepresentations were made with respect to

"material" matters and with the requisite degree of scienter.

1. Misrepresentations

The record demonstrates that several of respondents' claims were false. Reagan conceded that the published trading results were based only on hypothetical trades and that "real dollars" were never earned. Tr. 123, 156-59, 163-68. However, R&W promotional materials and advertisements made claims that the R&W computerized trading software actually earned profits. See. e.g., DX l, 2, 3 (profits were "generated"); DX 9, 10 (investments were "turned. ..into "...fortune"; profits were "made"). The advertisements strengthened the inference that these "profits" were real by indicating that there were "account balances" and "bank balances," DX 4, 5, 6, and that such results were "certified," DX 2, 5, 8, 10, 18.

The record indicates that respondents also misrepresented the extent of their own use of the software and their personal experience in trading commodities. Reagan conceded that "neither [he, n]or any other principal at R&W, or R&W,

experienced any real balance sheet reportable to [the] IRS as a result of any futures trading using this or any other system." Tr. 154-55. Despite this fact, some advertisements and promotional materials indicated that respondents themselves were actively and profitably trading.[43] Moreover, to convince prospective customers of the legitimacy of their sales motives, respondents represented that they would benefit directly if more people traded pursuant to their software because of the effect that a large volume of trading would have on the value of their own purported commodities investments. DX 18, at 19.[44]

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[43]DX 1 (trading system has "made us" a 284% net profit); DX 7, 18, at 19 (claimed purpose in selling the software was so respondents could "increase [their] own trading capital!"); DX 7 (claim by respondents that they "have the bulk of [their] money in" the currencies and commodities for which the R&W and Reagan software generate signals); DX 6 (at the end of 1987 "we had realized (in just one year) a 182% profit'").

[44] Reagan also misrepresented his own professional experience in the commodities markets. Prior to his work with R&W, Reagan's only futures industry experience

In addition, the record demonstrates that respondents made additional misrepresentations concerning the risks involved with futures trading. Respondents' advertisements combined bold predictions of significant profit (see, e.g.. DX 1,2, 3, 6) with claims that risks are subject to specific limitations, such as their 110% money-back profitability guarantee (see. e.g., DX 1, 2, 3, 4). This combination of representations amounts to a "guarantee of profits prohibited under Section 4b of the Act." Levine v. Refco, Inc., [1987 -1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,488 at 36,115 (CFTC July 11,

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involved two "equity raiser" positions with brokerage firms, neither of which required his registration with the Commission. Tr. 103, 140. Reagan admitted that he had never traded futures, had a futures account, or even attempted to open a futures account Tr. 141-42; but cf. Tr. 84 (Cullen testifying that, in 1988. Reagan opened three trading accounts through Cullen at Prudential, for which Reagan had discretion to trade). Despite his inexperience, one promotion describes Reagan as a "well-seasoned commodities trader with an excellent profits track record." DX 18, at 3.

1989).

We reject R&W and Reagan's claim that their advertisements "clearly impl[y] appreciable risk." R&W and Reagan point us to language in one specific promotion that does -- to some extent -- warn investors of risks involved with trading futures. DX 18 at 3 ("Futures trading requires your daily attention"; "If you're just getting into the markets, be a small trader for at least a year"; "If you are uncertain about the risks, 'paper trade' for six months."). Resp. Br. at 27. However, these mildly cautionary statements are insufficient to undo R&W's false promise of easy profits. They are contained exclusively within one lengthy R&W promotion, and other language on the same page dangles the idea of simple, substantial profits. DX 18 at 3 ("The use of a good trading system can consistently yield profits in the 50-150 percent per year range"; "Futures are, in actuality, less risky than equities. ...One can be wrong 50-60 percent of the time and still make a fortune.").

2. Materiality

The facts that respondents misrepresented were

material. A statement or omitted fact is "material" if a reasonable investor would have considered the information important in making a decision to invest. TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976); Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972). A reasonable investor would regard the fact that the published profits were never actually earned as significant information likely to influence his or her purchase decision.

Commission Rule 4.41, which regulates advertising by CTAs, succinctly describes the "inherent limitations" of the predictive value of hypothetical trading results:

> Unlike an actual performance record, simulated results do not represent actual trading. Also, since the trades have not actually been executed, the results may have under- or over-compensated for the impact, if any, of certain market factors, such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight.

17 C.F.R. § 4.41(b)(1). This rule, which sets forth the required disclosure in advertisements which set forth simulated results, reflects the Commission's position that the differences between hypothetical and actual trading for predictive purposes are significant and that consumers are entitled to know when published results are fictional. Because of the limited predictive value of hypothetical results, "a reasonable customer would think it material that the trading program...had never been tested through actual trading." Levine, & 24,488 at 36,115; Muniz v. Lassila, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 25,225 at 38,650 (CFTC Jan. 17, 1992); see also Armstrong, ¶26,332 at 42,612. Cullen's testimony amply demonstrates the inherent difficulties with actually executing computerized trading signals. Tr. at 92-97(explaining the difficulties of trading at the open in a volatile market, the effects of interday trading, and the inability of certain customers to withstand consistent losses).

R&W and Reagan argue that their trading results are distinguishable from "hypothetical results," despite the absence of any actual trades.

They argue that their trading results were achieved by taking existing algorithms and applying them prospectively, without modification based on hindsight. R&W and Reagan submit that their results were therefore less subject to manipulation and more reliable than the performance results generated from backward-looking, "hypothetical" tests about which the Commission seemed most concerned when adopting Commission Rule 4.41(b). Resp. Br. at 21-22; see Amendments to CPO and CTA Disclosure Rules. 60 Fed. Reg. at 38,146, 38,168 (1995) ("Hypothetical results are based on hindsight and can be readily manipulated.").

R&W and Reagan's argument is not persuasive. First, they have not developed a credible record that supports their description of R&W simulated testing.

Moreover, even were we to credit R&W and Reagan's description of the nature of its testing, trading results not generated with the use of actual trades suffer from most of the same limitations associated with backward-looking hypothetical trading. See generally DX 22, at 6; Tr. 57-71 (expert testimony of Driscoll that R&W's

results can offer no assurance that an R&W customer could have executed trades at the prices indicated and cannot account for the ability of an R&W customer to withstand losses or adhere to a particular trading program). As we explained in Armstrong, there are many important differences between actual trading and transactions that are not actually executed in the market. See ¶26,332 at 42,612. Even if R&W's purported method of testing possesses a somewhat higher degree of predictive power than backward-looking tests, its method still lacks an important grounding in reality. Whereas actual trading can convey to a customer that "these results have been achieved," R&W's method can only convey that "these results might have been possible." Such a distinction is an important one to reasonable customers.

R&W and Reagan also argue that, without an affirmative showing that actual trading results would have differed from the simulated results, a material distinction between the two is not demonstrated. Resp. Br. at 19-20. We disagree. The materiality of the distinction is reflected in the lower value that a reasonable consumer would place on a system backed only by

hypothetical trading. Although unlikely, even if one actually trading could have achieved the same results as the simulated profits, it is impossible either to prove or disprove this after the fact. To account for all risk factors, an "actual trade" -- for the purposes of marketing the trading system -- requires actual trading pursuant to the R&W trading signals. Tr. 61-62 (testimony of Driscoll). Merely selecting historical trades that are consistent with the generated signals would not account for the risk of execution of the signals at the reference price, the ability of a customer to withstand losses, or liquidity. Tr. at 61-66 (testimony of Driscoll).[45]

Respondents' misrepresentations concerning their own use of the system are also material. These specific misrepresentations appear frequently throughout R&W's promotional materials, and sometimes are presented prominently. The use of a trading system by its developers is important to reasonable consumers

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[45]Moreover, there is evidence that the actual profitability of the R&W software was "substantial[ly]" lower than the advertised gains. Tr. 24-26, 48 (testimony of Otten).

because it reflects a meaningful vote of self-confidence and a sign of authenticity. Reasonable consumers are more impressed with a trading system when its makers and owners are confident enough to follow it themselves.[46]

3. Scienter

The record contains strong evidence that respondents acted with the requisite degree of scienter to support a finding of fraud. Section 4b "clearly require[s] that [respondents'] acts be done with knowledge of their nature and character." CFTC v. Savage, 611 F.2d 270, 283 (9th Cir. 1979). "'[M]ere negligence, mistake, or inadvertence' fails to meet section 4b's scienter requirement. ..." Drexel Bumham Lambert Inc. v.

[46]It is less clear that the misrepresentations concerning Reagan's experience and his development of the program were material. Certainly, a consumer would evaluate differently a computer trading system designed by one who has traded compared to a program designed by a person with Reagan's lack of futures experience. However, we have found only one location where this misrepresentation was made at the end of a lengthy promotion, which was distributed only after a prospective customer indicated initial interest. See DX 18, at 3. For that reason, we do not rely specifically on this misrepresentation as a basis for liability.

CFTC, 850 F.2d 742, 748 (D.C. Cir. 1988). The Division must show that respondents either "intentionally" committed wrongful acts or "recklessly disregard[ed]" their duties under the Act. Hammond v. Smith Barney, Harris Upham & Co., [1987- 1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,617 at 36,659 (CFTC Mar. 1, 1990); Do v. Lind-Waldock & Co., [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,516 at 43,320-211 (CFTC Sept. 27, 1995). A reckless action is one that "departs so far from the standards of ordinary care that it is very difficult to believe that the [actor] was not aware of what he was doing." Drexel Burnham, 850 F.2d 742 at 748; Do, ¶26,516 at 43,321. It is not necessary to show an "evil motive" or specific intent to injure the customer to establish the requisite scienter. Dohmen-Ramirez v. CFTC, 837 F.2d 847, 857 (9th Cir. 1988).

The record demonstrates that Reagan and R&W intentionally crafted R&W's advertisements to create a false picture of the trading system in the minds of prospective consumers. Reagan conceded that the respondents' advertised purpose for selling the system -- increasing their own trading capital -- was intended to give people

the impression that [someone at R&W, or R&W itself,] was actually trading." Tr. 173-75; see also DX 20, at 122-23 (Reagan testifying in a deposition that "we tried any attempt we could to get people away from the too good to be true [syndrome]"). These concessions demonstrate why Reagan's claim that he believed that there was no material difference between an actual trading account and R&W's simulated account is not credible.

Moreover, professions of ignorance by R&W and Reagan, even if believable, would constitute a reckless disregard for the legal significance of the omitted fact and of their duties under the Act. Despite respondents' asserted personal beliefs as to the efficacy of their product, the weight of opinion supports the principle that simulated results convey less reliable information than actual results about the predictive power of a trading system. Their omission of a demonstrably material fact left investors without a key piece of data with which to evaluate their purchase decisions and future investment choices. R&W and Reagan's willingness to conceal crucial information from their customers and to allow them to base their investment decisions upon

inaccurate information is a significant departure from ordinary standards of care. These factors alone -- even assuming that R&W and Reagan lacked the specific intent to harm their customers, see Tr. 167-68 -- support a finding of recklessness.

Reagan's other attempts to demonstrate that his behavior was "unintentional" similarly are not persuasive. At the hearing, Reagan attempted to convey his own belief in the truthfulness of the representations in the advertisements. See generally Tr. 149- 169, 177-80. For example, Reagan explained that his use of the word "certified" in marketing materials represented that the profitability of the trading system actually was achieved by customers. Tr. 161-62. However, respondents failed to offer into evidence any examples of customer account statements that would support such a claim. In addition, Reagan claimed that he "didn't want [R&W's advertisements] to be deceptive or misleading." In support of this claim, Reagan stated that, upon realizing that the "increasing our own trading capital" language might be deceptive, he removed it from the R&W promotional materials. Tr.177-180. Even if Reagan's testimony were

credible, however, respondents failed to support these claims with an example of a promotion where this language was not included.

4. "In connection with"

We also find that respondents' activities occurred "in connection with" futures trading. In evaluating the "in connection with" language of Section 4b(a), courts of appeals have determined that the legislative history of the Act "indicates a progressive trend toward broader application of the CEA." Saxe v. E.F. Hutton & Co., 789 F.2d 105, 111 (2d Cir. 1986) (emphasis added) (noting problems with "fraudulent pre-trading conduct"); Hirk v. Agri-Research Council. Inc., 561 F.2d 96, 103-04 (7th Cir. 1977).[47] Consistent with this broad application, courts have found violations of Section 4b(a) to exist where futures trading has not yet occurred;[48] where the actors are neither

[47]Remedial statutes are to be interpreted liberally so as to effectuate the Congressional purpose. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971).

[48]Hirk, 561. F.2d at 103-04 (concerning fraud in

members of a contract market nor directly involved in the sale or purchase of the futures contracts;[49] and where misrepresentations were made not about the underlying contracts to be traded, but about the quality of the source of the trading decisions.[50] Likewise, recent precedent

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solicitation); CFTC v. Skorupskas, 605 F. Supp. 923, 932- l-33 (E.D. Mich. 1985) (failure to disclose that a performance record does not represent the results of actual trading held to be a violation of Section 4b); Muniz, ¶25,225 at 38,650 (failure to disclose that a trading strategy was untested constitutes a Section 4b violation); but see Kearney v. Prudential-Bache Secs., Inc., 701 F. Supp. 416,422-24 (S.D.N.Y. 1988).

[49]Saxe, 789 F.2d at 111 (explaining that Section 4b was amended in 1968 to extend coverage from "members of the contract market" to "any person").

[50]Saxe, 789 F.2d at 110 (misrepresentations that a CTA was experienced and would use sophisticated computer program "custom-tailored" to the specific investor's objectives to trade a discretionary trading account are "in connection with" futures contracts); Hirk, 561 F.2d at 98, 103-04 (misrepresentations concerning the profitability of a CTA and the competency and experience of the professionals on the staff constitute a violation of Section 4b).

supports our conclusion that Section 4b(a) is broad enough to cover respondents' activities. See AVCO, ¶27,173 at 45,583 ("allegations that AVCO failed to disclose that [its computerized trading system's] advertised performance record did not represent the results of actual trading but hypothetical trading satisfy the 'in connection with requirement'")(citing Skorupskas 605 F. Supp. at 933).

The respondents in this case marketed their computerized trading systems not merely as computer software, but as a tool specifically for use in the futures markets. Customers were to base their futures investments on the signals, in many cases following the signals exactly. Tr. 37. Furthermore, respondents' misrepresentations went directly to "the risks involved or investment characteristics" of the futures transactions. Kearney v. Prudential-Bache Secs. Inc., 701 F. Supp. 416,425 (S.D.N.Y. 1988). Respondents' misrepresentations and omissions not only misrepresented the value of their computer software program, but also downplayed the risks involved in futures trading. Like most fraudulent solicitations actionable under Section 4b(a), the

respondents' misrepresentations related directly to the "characteristics and attributes that would induce an investor to buy or sell. ..futures contract[s]." Id. at 424.

R&W and Reagan contend that cases such as Kearney and Saxe demonstrate that the "in connection with" language requires proof of a greater connection between the fraud and a commodities transaction than is present in this case. Resp. Br. at 34- 35. For example, they argue that in Saxe the Second Circuit emphasized that misrepresentations concerning the quality of a CTA's operation were actionable only because the accounts were discretionary accounts for unsophisticated investors. 789 F.2d at 110 (explaining that such a combination of authority and unsophistication caused "misrepresentations about the risks of commodities trading [to] affect[ ] all subsequent trades made on [the investor's] behalf"). However, unlike the cases that have found the connection between the fraud and the trading lacking, the misrepresentations in this case are neither incidental nor secondary to the futures trading but are related directly to that trading. In fact, the gravamen of the claim is that the respondents misled potential purchasers of

their system concerning trading profits and trading risks in order to induce customers to trade, and there is ample evidence to show that they did trade.[51]

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[51]Equally misguided is R&W and Reagan's argument (Resp. Br. at 31-32) that United States v. O'Hagan, 117 S. Ct. 2199 (1997), indicates that the "in connection with" language requires that an actual transaction be an "essential" part of the fraud. In O'Hagan, the Court held that where one misappropriates nonpublic information, the "in connection with" requirement of Section 10(b) of the Securities Exchange Act is met only when the misappropriater "uses the [misappropriated information] to purchase or sell securities." Id. at 2209 (emphasis added) (analyzing the "in connection with" requirement of Section 10(b)). However, an actual transaction was required in O'Hagan to consummate the fraud because until that point no harm had been caused by the misappropriation. ("The securities transaction and the breach of duty ...coincide."). In contrast to a case involving misappropriation, R&W and Reagan breached their duty to investors when they accepted the purchase price for their computerized trading system even before any actual trading occurred. Customers' decisions to buy the software were based on false representations that concerned trading profits and were designed to induce trading. See Hirk, 561 F.2d at 103-04.

That the "in connection with" language in Section 10b of the Securities Exchange Act of 1934 requires an actual purchase or sale of a security before liability for fraud is

demonstrated, see Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975), does not alter our conclusion that R&W and Reagan violated Section 4b of the Commodity Exchange Act. The degree of concern about vexatious litigation that drove the adoption of an actual purchase or sale requirement in Blue Chip Stamps, id. at 740-44, is not present in either administrative enforcement actions (compare O'Hagan, 117 S. Ct. at 2213 ("Criminal prosecutions do not present the dangers the Court addressed in Blue Chip Stamps, so that decision is inapplicable to indictments for violations of 10(b) and Rule 10b-5.")) or in the futures industry, where private rights of action, 7 U.S.C. §25(a), and conditions for strike suits, absent a purchase or sale, are limited. Even if the Blue Chip Stamps rule were adopted in the futures industry, which we do not believe would be appropriate, as indicated above there is ample evidence in the record that R&W's customers made orders for futures contracts: Otten, Cullen, and Reagan all testified that there were R&W customers who traded pursuant to R&W's system. Moreover, courts interpret the Ain connection with" language in Section 10b more broadly in administrative enforcement actions, such as this one, than in actions brought by private plaintiffs. Loss & Seligman, IX Securities Regulation at 3690-91 & nn.574-76 (1992).

Therefore, we find that R&W and Reagan made material misrepresentations in violation of Section 4b of the Act and affirm the initial decision in that respect.

C. Section 4o of the Act and Commission Rule 4.41 (a): Fraud as a CTA and Fraudulent Advertising

Section 4o(1) of the Act provides that:

> It shall be unlawful for a CTA ...by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly-
>
> (A) to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant; or
>
> (B) to engage in any

> transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.

7 U.S.C. § 6o. Because we have found that R&W and Reagan violated Section 4b(a) of the Act and that they acted as CTAs, further analysis is not needed to conclude that R&W and Reagan also violated Section 4o(1) of the Act. We therefore affirm the decision of the ALJ in this respect.[52]

Similarly, because we find that R&W and

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[52]R&W and Reagan do not challenge our ability to interpret Section 4o, in its capacity as an antifraud provision, as applying to CTAs. Their statutory arguments concerning the proper interpretation of Section 1a(5) of the Act flow only from their constitutional concerns about the alleged discretionary licensing system" under the CEA. Resp. Br. at 15, 19. Although it applies to CTAs, Section 4o does not contain a registration requirement. Therefore, the constitutionality of applying Section 4o to CTAs is not before us, and we need not address it.

Reagan violated Section 4o of the Act, we find that they also violated Commission Rule 4.41 (a) and affirm the conclusion of the ALJ, albeit on slightly different grounds. Commission Rule 4.41 (a) prohibits fraudulent advertising, using language almost identical to Section 4o of the Act:

> No. ..CTA, or any principal thereof, may advertise in a manner which:
>
> (1) Employs any device, scheme or artifice to defraud any participant or client or prospective participant or client; or
>
> (2) Involves any transaction, practice or course of business which operates as a fraud or deceit upon any participant or client or any prospective participant or client.

17 C.F.R. § 4.41(a) (emphasis added).

The ALJ found that respondents violated Commission Rule 4.41, but based his findings of liability on respondents' failure to attach the disclosure contained in Rule 4.41(b). Id. at 45,728 n.79. Whether or not R&W and Reagan violated Commission Rule 4.41 (b), the Division only charged a violation of Commission Rule 4.41 (a). Compl. ¶¶ 27 -30. The conduct of R&W and Reagan that violates Commission Rule 4.41(a) is the same conduct that violates Sections 4b and 40 of the Act making fraudulent misrepresentations in their advertising. Therefore, we hold that R&W and Reagan violated Commission Rule 4.41(a).[53]

[53]Certainly, R& W could have taken large strides toward remedying the fraudulent nature of its advertisements by including the disclosure in Rule 4.41 (b) in their advertisements. Contrary to the implication of the initial decision, however, placing the required 4.41(b) disclosure in R&W's advertisements would not necessarily have cured the severe problems in the advertisements and promotional materials to the extent needed to prevent a finding of liability under Commission Rule 4.41(a).

D. Controlling Person Liability: Section 13(b) of the Act

Section 13(b) of the Act sets forth the requirements for controlling person liability under the CEA:

> Any person who, directly or indirectly, controls any person who has violated any provision of this chapter or any of the rules, regulations, or orders issued pursuant to this chapter may be held liable for such violation in any action brought by the Commission to the same extent as such controlled person. In such action, the Commission has the burden of proving that the controlling person did not act in good faith or knowingly induced, directly or indirectly, the

act or acts constituting
the violation.

7 U.S.C. §13c(b). Therefore, a person is liable as a controlling person if that person (1)"controls" any person who has committed a violation of the Act or the Commission's regulations and (2) did not act in "good faith" or "knowingly induced" the acts constituting the violation. Because Reagan stipulated that he "control[s]" R&W "within the meaning of Section 13(b) of the Act," controlling person liability turns on whether Reagan acted with the requisite scienter. In order to show knowing inducement, the Division must show "that the controlling person had actual or constructive knowledge of the core activities that constitute the violation at issue and allowed them to continue." In re Spiegel, [1987-1990 Transfer Binder], Comm. Fut. L. Rep. (CCH) ¶24,103 at 34,767 (CFTC Jan. 12, 1988) (footnote omitted). Moreover, "if the controlling person knowingly induces acts that amount to a violation, he will not escape liability merely because he acted in good faith." Id.

Reagan, who wrote and/or reviewed all of the advertisements and promotional materials for

R&W, never disputed that he had actual knowledge of the "core activities" that would constitute violations by R&W of Sections 4b(a) and 4o of the CEA and Commission Rule 4.41. Reagan's only defense seems to be that he thought that all of the core activities were perfectly legal. As explained above, Reagan's purported good faith is no defense in light of his knowing inducement of R&W's violations. Therefore, we hold that Reagan is liable as a controlling person for R&W's violations of Sections 4b and 4o of the Act and Commission Rule 4.41 (a) and affirm the initial decision in this respect.

E. Aiding and Abetting Liability: Section 13(a) of the Act

Section 13(a) of the Act provides that:

> Any person who commits, or who willfully aids, abets, counsels, commands, induces, or

> procures the commission of, a violation of any of the provisions of this chapter, or any of the rules, regulations, or orders issued pursuant to this chapter, or who acts in combination or concert with any other person in any such violation, or who willfully causes an act to be done or omitted which if directly performed or omitted by him or another would be a violation of the provisions of this chapter or any of such rules, regulations, or orders may be held responsible for such violation as a principal.

7 U.S.C. §13c(a). The Commission has held that aiding and abetting liability requires a showing of respondent's "'knowing participation' in the

unlawful venture." In re Western Fin. Management, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,814 at 31,401 (CFTC Nov. 14, 1985). Not only must the Division demonstrate a respondent's "knowledge" of the underlying wrongdoing, but it also must show that respondent "intentionally assisted" the primary wrongdoer. Korn v. Great American Commodities, Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,397 at 39,357 (CFTC Oct. 2, 1992).[54]

With regard to aiding and abetting R&W's violations of the antifraud provisions of the Act, our above discussion regarding Reagan's scienter is pertinent and dispositive. See supra, Discussion Section II(B)(3). As we explained, Reagan intentionally assisted R&W's fraud, which is sufficient to establish aiding and abetting liability. Therefore, we hold that Reagan is liable for aiding and abetting R&W's violations of Sections 4b and 4o and Commission Rule 4.41 (a)

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[54]As with controlling person liability, "[i]gnorance of the law is no more a defense for the aider and abettor than it is for the primary wrongdoer." In re Lincolnwood Commodities, [1982-1984 Transfer Binder] ¶21,986 at 28,255 (CFTC Jan. 31, 1984).

and affirm the initial decision in this respect.

F. Registration, Recordkeeping and Production of Records

We view this case primarily as an action to enforce the antifraud provisions of the Act and our regulations. As we explain below, R&W and Reagan's violations of these provisions are serious and warrant substantial penalties. Other findings that R&W and Reagan failed to register in violation of Section 4m of the Act, 7 U.S.C. §6m, and that R&W violated the Commission's recordkeeping and production rules, Commission Rules 4.33 and 1.31, 17 C.F.R. §§ 4.33 and 1.31, would add little to the gravity of their offenses. Cf. In re Interstate Securities Corp., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,295, at 38,955 (CFTC June 1, 1992). In light of these circumstances, we believe that it is unnecessary to reach the merits of these charges or any constitutional issues concerning whether R&W and Reagan might be sanctioned for failure to register.

G. Bias

Turning to the question of whether the ALJ's decision was tainted by an impermissible bias, we find that the administrative proceedings suffered from no such infirmity. Generally, in examining allegations of bias, we apply Commission Rule 10.8(b)(2), 17 C.F.R. § 10.8(b)(2), which the Commission has interpreted to require disqualification if the record establishes ihat a presiding officer has: (1) a personal bias stemming from an extrajudicial source or (2) deep-seated favoritism or antagonism that would make a fair judgment impossible. In re Mayer, CFTC Docket No. 92-21, 1998 WL 80513 at *16 (CFTC Feb. 25, 1998), appeal pending, No. 98-4099(L) (2d Cir.). Bias, at a minimum, reflects an unfavorable disposition toward a party or his case. In addition, the party seeking disqualification must show that the unfavorable disposition is wrongful, or inappropriate "either because it is undeserved, or because it rests upon knowledge that the subject ought not to possess. ..or because it is excessive in degree." Id.

Portions of the initial decision consist of the ALJ's opinions on the valuelessness of technical

trading systems. See, e.g., I.D. at 45,728 n.75 (marketer's claim of increased profitability or reduced risk through the use of [technical trading] systems is likely to be fraudulent"). The ALJ also appears to have concluded in several places that the trading system did not (and could not) work and that respondents did not successfully simulate the results published. The ALJ supported his opinions with extensive citations to economics literature and case law discussing the efficient capital markets model.

Nonetheless, the ALJ's central findings of fact and conclusions of law with respect to the respondents' misrepresentations are clearly supported by the evidence in the record. The ALJ's opinions concerning the efficacy of the trading system and whether the respondents successfully blind-tested their software are unrelated to those basic findings and appear to us to be mere dicta.[55] This dicta is not of the type

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[55]The efficacy of the system -- as the Division and the respondents agree -- was irrelevant to the findings of fraud. However, as explained above (see supra, Discussion Section 1), findings concerning efficacy could have an impact on the sanctions analysis.

or severity to make a case of bias or deep-seated antagonism. In any event, our review of this case has been de novo, which cures any error that may have existed.

III. Sanctions[56]

A. Cease and Desist Orders

We find that the record supports the imposition of a cease and desist order on Reagan and R&W. Cease and desist orders are appropriate where there is a reasonable likelihood the conduct will be repeated. Mayer, 1998 WL 80513 at *29. One indicator of the likelihood of future violations is the existence of a pattern of past conduct. Id.

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[56]As we mentioned above, with respect to the Worsham estate only the claim for restitution is before us. After Worsham's death, the Division abandoned its claims against him for civil monetary penalties, a trading ban, and a cease and desist order.

The record demonstrates a repeated pattern of misrepresentations, as the Division entered into evidence a set of misleading advertisements that appeared monthly in Futures magazine for a period in excess of two years. Moreover, R&W published the same type of advertisement in Investor's Business Daily as recently as February 10, 1997, well after the complaint was filed in this case. DX 11. In light of these facts, we affirm the ALJ's order that Reagan and R&W cease and desist from violating Sections 4b and 4o of the Act and Commission Rule 4.41(a).[57]

B. Trading Bans

We find that the ALJ's imposition of a permanent trading ban is not supported by the record, and we vacate that particular sanction." The factors to be considered in imposing a contract market trading ban. ..include the

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[57]Because we do not reach the other claims, we vacate the ALJ's order that R&W and Reagan cease and desist from violating Section 4m(1) of the Act and Commission Rules 1.31 and 4.33.

existence of a nexus between the violation and the integrity of the futures market. ..." Mayer, 1998 WL 80513 at *30 (quoting In re Citadel Trading Co., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,082 at 32,191 (CFTC May 12,1986)). A ban is appropriate when violations affect the prices of futures contracts or interfere with normal trading patterns. A ban is equally appropriate where there is "an injury to the integrity of the market in the public eye." Mayer, 1998 WL 80513 at *30 (quoting In re Miller, [1994-1996 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,440 at 42,914 (CFTC June 16, 1995). "A trading ban is a remedial sanction imposed to protect the futures markets from conduct which inherently threatens their orderly operation." In re Incomco. Inc., [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,198 at 38,537 (CFTC Dec. 30, 1991).

Where the underlying violations involve trade practice violations, the damage caused to the integrity of the markets is clear. See. e.g., Mayer, 1998 WL 80513, at *30-31 ; In re Reddy, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,271 at 46,214 (CFTC Feb. 4, 1998), appeal pending, No.98-4070 (2d Cir.); In re Elliott,

[Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,243 at 46,008 (CFTC Feb. 3, 1998), appeal pending, No.98-1305 (7th Cir.); In re Rousso, (Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,133 at 45,311 (CFTC Aug. 20, 1997); In re Gimbel, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,213 at 35,004 (CFTC Apr. 14, 1988), aff'd in relevant part, 872 F.2d 196 (7th Cir. 1989). The integrity of the markets also can be harmed by conduct removed from the exchange floor, such as trading-related fraudulent conduct that denies customers a reasonable opportunity to profit or failing to follow regulations designed to maintain orderly markets. See, e.g., In re Commodities International Co., [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶26,943 at 44,567 (CFTC Jan. 14, 1997) (commodity pool operator charged an exorbitantly high "annual management fee"); In re GNP Commodities, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶&25,360 at 39,222 (CFTC Aug. 11, 1992)(fraudulent allocation of trades), aff'd sub nom Monieson v. CFTC, 996 F.2d 852 (7th Cir. 1993); Incomco, ¶25,198 at 38,537 (failure to carry futures accounts in true name of person for whom account was maintained and failure to file forms for reportable

positions); In re Ralli Bros., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,314 at 32,874 (CFTC Oct. 8, 1986) (failing to respond to special call); In re Bamaodah, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,010 at 31,998 (CFTC Apr. 18, 1986) (failing to file reports of reportable positions).

However, our precedent does not support the imposition of a trading ban in circumstances like those in the present case. We have never imposed a trading ban on an entity or an individual who never actually traded futures or options, acted as a controlling person with respect to such trading, or was involved in an attempt to manipulate or distort commodity prices. See. e.g., In re Polvaxon Capital, Inc., [1987- 1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,910 at 34,222 (CFTC Sept. 9, 1987); Monieson v. CFTC, 996 F.2d 852, 862-63 (7th Cir. 1993); In re First Regal Commodities. Inc., [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶22,600 at 30,570-71 (CFTC May 22, 1985); In re Premex, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21,992 at 28,370-71 (CFTC Feb. 1, 1984), aff'd in relevant part, 785 F.2d 1403 (9th Cir. 1986); In re Sanchez,

[1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶21, 85 at 28,213 (CFTC Jan. 31, 1984), aff'd 759 F.2d 767 (9th Cir. 1985).

In the instant case, we do not believe that the integrity of the markets has been sufficiently threatened by R&W and Reagan's conduct to warrant imposition of trading bans. R&W and Reagan did not themselves trade futures, did not manage accounts for clients, and did not seek to manipulate prices. Under these circumstances, we do not think a trading ban, which is a remedial sanction, is necessary in this case to address potential harm to the futures markets.

C. Civil Monetary Penalties

In enforcement proceedings, we impose sanctions "to further the Act's remedial policies and to deter others in the industry from committing similar violations." Mayer, 1998 WL 80513, at * 7. We may assess a civil monetary penalty of "not more than the higher of $100,000 or triple the monetary gain to such person for each such violation." Section 6 (c) of the Act, 7

U.S.C. §9 (1994). We do not rely on a specific formula in assessing de novo appropriate level of civil monetary penalties; rather, we focus on the relative gravity of respondents' misconduct in light of the following factors:

> (1) the relationship of the violation at issue to the regulatory purposes of the Act; (2) respondents state of mind; (3) the consequences flowing from the violative conduct; and (4) respondent's post-violation conduct. In addition, [the Commission] consider[s] any mitigating or aggravating circumstances presented by the facts.

Grossfeld, ¶26,921 at 44,467-68 (footnotes omitted). The "financial benefit that accrued to the respondent and/or the loss suffered by customers as a result of the wrongdoing are

especially pertinent factors to be considered." Id. at 44,468; see In re Gordon, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶25,667 at 40,182 (CFTC Mar. 16, 1993).

Considering R&W and Reagan's fraudulent conduct, our analysis of the Grossfeld factors leads us to conclude that the gravity of their offenses is significant. Fraud is a violation going to the core provisions of the Act." ¶26,921 at 44,468. Moreover, the record demonstrates that, over a sustained period of time, Reagan acted with wrongful intent when he penned the misrepresentations in R&W's advertisements. R&W and Reagan's post-violative conduct also adds to the gravity of their violations. The Division presented evidence that R&W published the same type of fraudulent advertisement in Investor's Business Daily as recently as February 10, 1997, well after the complaint was filed in this case. DX 11.

For the violations of the antifraud provisions, we agree with the ALJ that the appropriate amount of civil monetary penalties in these circumstances starts with an estimate of the

monetary gain to R&W and Reagan as a result of their conduct.[58] By this measure, we attempt to ensure that those who engage in fraudulent activity do not benefit from it and to deter others from engaging in similar activity. We find that the ALJ's calculation of $2,375,000, which was based on the minimum price paid for an R&W trading system ($2,500) multiplied by approximately 950 customers, is an appropriate estimate.[59] In

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[58]The alternative would be to assess up to $100,000 "for each such violation." Section 6(c) of the Act, 7 U.S.C. §9. In a solicitation fraud case such as this, it is difficult to quantify the number of violations that occurred; respondents made numerous misrepresentations to hundreds of individuals through its mass marketing campaign. Because we can calculate a reasonable estimate of the monetary consequences, we think that such an amount presents a more tangible -- and justifiable -- basis for any penalty we assess. The existence of demonstrable gains or customer losses distinguishes solicitation fraud cases from trade practice cases and results in our different approach to civil monetary penalties. Compare Rousso, ¶27,133 at 45,310-11.

[59]This "consequences" determination is founded on a reasonable presumption of causation. Because the misrepresentations were widely disseminated and because

certain respects, the ALJ's calculation of monetary benefit to R&W and Reagan was not as conservative as it could have been. For example, his estimate reasonably could have been based on a lower number of customers and could have taken into account record evidence concerning R&W's expenses. However, in other respects the ALJ's estimate of the financial consequences was not as high as it could have been. Based on the evidence in the record, it would be reasonable to conclude that the minimum price and/or the average price charged to R&W customers exceeded $2,500 per system.[60] Therefore, given

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Reagan testified that nearly 100% of their customers during the relevant time period learned about the company through the advertisements, it is reasonable to conclude that substantially all of R&W's customers relied on the advertised claims in making their purchase decisions.

[60]The ALJ calculated the financial benefit to respondents on the basis of a minimum price of $2,500 per system. Although Reagan testified that R&W sold its CurrencyMaster trading system for a minimum of $2,500 during April 1993 through March 1996, the time period covered by the complaint, the record suggests that the minimum price was actually more than that. The documentary evidence reveals that the price being charged in April 1993 was $3,495. Tr.

the record that we have before us, we find that the ALJ's estimate of $2,375,000 is a reasonable estimate of the approximate monetary gain to R&W and Reagan.[61]

192; DX-1 (advertisement used in April 1993). From there, the price for the system increased steadily to $3,995 in 1996 and $5,000 by April 1997 .Tr. 192-93. A reasonable assumption would be that the minimum price was $3,495 during the relevant time period. The record also demonstrates that in April 1994 Treasury Master and EuroMaster sold for $3,995 each. In that same month, CurrencyMaster customers received a limited offer of $ 4,500 for both TreasuryMaster and EuroMaster. DX 20, CFTC Exh.11. R&W also sold Enhanced CurrencyMaster to CurrencyMaster customers for $925. Id.

[61]Despite R&W and Reagan's argument that the Division did not meet its burden of demonstrating a precise figure, Resp. Br. at 47, nothing prevented them from offering evidence to counter the gross sales estimates.

Significant evidence that the R&W system generates consistent profitability -- in line with the advertised levels -- might have mitigated the consequences of respondents' misrepresentations. However, most of the evidence in the record in support of the respondents' claim that the system produced profits consists of Reagan's testimony, which lacks credibility mostly because it is unsubstantiated.[62] For example, Reagan explained that R&W's "certifying" of results stemmed from the fact that customers were actually making money using the R&W software. Without presenting statistically significant corroborating evidence, however, Reagan has

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[62] The ALJ found Reagan's "self-serving" testimony to be not credible, because, among other things, no part of it was corroborated. Id. at 45,720-21. Moreover, the ALJ pointed to inconsistencies between Reagan's testimony and his sworn statements concerning the extent of Reagan's assets, I.D. at 45,721 n.34, and the extent of his knowledge of the financial aspects of the company, I.D. at 45, 736 n.133. Upon review of the record, there are no compelling reasons to disagree with the conclusion of the ALJ. This credibility determination is bolstered due to Reagan's demonstrated intent to deceive R&W's customers.

provided us with nothing to support the credibility of his representations. Moreover, Otten's testimony about his actual trading results is inconsistent with R&W's advertised representations.[63] Tr.24-26, 48 (Otten once calculated that his actual trading results were substantially less than R&W's advertised results for the same period).

On the other hand, while the record fails to demonstrate that actual use of the system generated the huge profits claimed in the advertisements, there is testimony from both Otten and Cullen that results from actual use of the computerized trading systems were somewhat positive. Tr. 40 (testimony of Otten that he found the R&W system more consistently profitable" than other systems he had tried); Tr. 85

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[63]Even if credible, Reagan's claim that only 11 out of 950 customers had ever requested that their money back guarantee be honored would add little to our "consequences" analysis. Because the terms of the guarantee contain significant restrictions, the number of customers who invoked the guarantee is not a reliable indicator of the true extent of customer satisfaction with the system.

(testimony of Cullen that, of three discretionary accounts traded in 1988 by Reagan pursuant to an unnamed R&W trading system, two "made money").

This independent evidence is limited and far from a whole-hearted endorsement of the benefits of the system.[64] However, the lack of meaningful evidence of customer trading losses does tend to affect somewhat our view of the consequences of the respondents' actions. As a result, we find that the gravity of R&W and Reagan's fraud, while severe, was not proved to be egregious enough to warrant trebling of the monetary gains. In this respect, we modify the initial decision.

In light of the total gravity of R&W and Reagan's violations of the Act and the Commission's Rules,

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[64]Most of Cullen's testimony relates to the difficulty he experienced in actually trading according to the generated signals. Similarly, Otten's testimony suggests that many customers would lose money by using R&W's system. Otten explained that the signals produced periods of substantial drawdowns and that it takes more money than R&W claims it takes to trade comfortably.

we impose upon R&W and Reagan civil monetary penalties of $2,375,000, to be paid by them jointly and severally.

D. Restitution

Turning to the issues concerning restitution, we affirm the ALJ's denial of an award of restitution. Our authority to award restitution stems from Section 6(c) of the Act, which provides that we may require restitution to customers of damages proximately caused by violations of such persons." 7 U.S.C. §9. In re Staryk, we addressed for the first time our authority to award restitution. We provided guidance on the appropriateness of any such award, including our admonition that "restitution should not be ordered as an empty gesture of goodwill." Id. As a result, the ability to pay a restitution award must be explored before making an award of restitution.

Other factors to consider include the equities weighing in favor of or against an award of restitution, the degree of complexity likely to be involved in establishing the claims of individual

customers, the likelihood that customers will obtain compensation through their own efforts, the availability of resources to administer restitution, and any other matters that justice may require. ¶27,206 at 45,812 & n.15. We also explained in that the amount of restitution depends on the number of injured persons and the amounts of their damages." Id. at 45,812. In addition, the Division must prove that the damages were proximately caused by the violations. Id.

In this case, determining the amount or appropriateness of restitution would be complex. Due to the statutory requirement of proximate cause, we would need to determine whether as many as 950 individual customers benefitted or lost on the basis of their use of the R&W trading system, placing a substantial burden on our adjudicatory resources.[65] Moreover, those

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[65]Contrary to the Division's suggestion, a restitution analysis cannot be made less complex by ignoring evidence of customer trading results See Div. Br. at 16 n.6. Although it is probable that some customers incurred trading losses in reliance on the R&W software, it appears that some customers may have profited through use of the trading

customers with large losses have the opportunity to pursue their claims against R&W and Reagan directly. The other sanctions imposed in this case are adequate to deter the serious violations involved.

For these reasons, we affirm the ALJ's denial of restitution.

CONCLUSION

Consistent with the foregoing, we hold that respondents violated Sections 4b and 4o of the Act and Commission Rule 4.41 (a) and hereby order that R&W and Reagan cease and desist from violating those statutory and regulatory provisions. We also find that Reagan and the Worsham estate are liable as aiders and abettors and as controlling persons, under Section 13(a) and 13(b) of the Act, for R&W's violations. We reduce the amount of civil monetary penalties imposed upon R&W and Reagan by the ALJ from $71125,000 to $2,375,000 and order them to pay that amount. We vacate the ALJ's findings that respondents violated Section 4m(1) of the Act and Commission Rules 1.31 and 4.33, the ALJ's order

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signals.

that R&W and Reagan cease and desist from violating those statutory and regulatory provisions, and the ALJ's imposition of trading bans upon R&W and Reagan. We deny an award of restitution.

IT IS SO ORDERED.

By the Commission (Chairperson BORN and Commissioners HOLUM, SPEARS and NEWSOME).[66]

Jean A. Webb
Secretary of the Commission
Commodity Futures Trading Commission

Dated: March 16, 1999

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[66]A motion to stay the effect of this decision pending reconsideration by the Commission or review by a court must be filed within 15 days of the date this order is served

3. Statutes

Commodity Exchange Act
§ 1a(5), 7 U.S.C. § 1a(5)

Commodity Exchange Act
§ 4b(a), 7 U.S.C. § 6b(a)

Commodity Exchange Act
§ 4o, 7 U.S.C. § 6o

Commodity Exchange Act
§ 1a(5), 7 U.S.C. § 1a(5)

(6) IN GENERAL. -- Except as otherwise provided in this paragraph, the term "commodity trading advisor" means any person who –

(1) for compensation or profit, engages in the business of advising others, either directly or through publications, writings, or electronic media, as to the value of or the advisability of trading in –

(1) any contract of sale of a commodity for future delivery made or to be made on or subject to the rules of a contract market;

(2) any commodity option authorized under section 4c; or

(3) any leverage transaction authorized under section 19; or

(ii) or compensation or profit, and as part

of a regular business, issues or promulgates analyses or reports concerning any of the activities referred to in clause (i).

(2) EXCLUSION. – Subject to subparagraph (C), the term "commodity trading advisor" does not include –

(1) any bank or trust company or any person acting as an employee thereof;

(2) any news reporter, news columnist, or news editor of the print or electronic media, or any lawyer, accountant or teacher;

(3) any floor brokers or futures commission merchant;

(4) the publisher or producer of any print or electronic data of general and regular dissemination, including its employees;

(5) the fiduciary of any defined benefit plan that is subject to the Employee

Retirement Income Security Act of 1974 (29 U.S.C. 1001 et seq.);

(6) any contract market; and

(7) such other persons not within the intent of this paragraph as the Commission may specify by rule, regulation, or order.

(3) INCIDENTAL SERVICES - Subparagraph (B) shall apply only if the furnishing of such services by persons referred to in subparagraph (B) is solely incidental to the conduct of their business or profession.

(4) ADVISORS - The Commission, by rule or regulation, may include within the term "commodity trading advisor", any person advising as to the value of commodities or issuing reports or analyses concerning commodities if the Commission determines that the rule or regulation will effectuate the purposes of this subparagraph.

Commodity Exchange Act
§ 4b(a), 7 U.S.C. § 6b(a)

It shall be unlawful (1) for any member of a contract market, or for any correspondent, agent, or employee of any member, in or in connection with any order to make, or the making of, any contract of sale of any commodity in interstate commerce, made or to be made, on or subject to the rules of any contract market, for or on behalf of any other person, or (2) for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made or to be made, for or on behalf of any other person if such contract for future delivery ir or may be used for (A) hedging any transaction in interstate commerce in such commodity or the products or by products thereof, or (B) determining the price basis of any transaction in interstate commerce in such commodity, or (C) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof -

(5) to cheat or defraud or attempt to cheat or defraud such other person;

(6) willfully to make or cause to be made to such

other person any false report or statement thereof, or willfully to enter or cause to be entered for such person any false record thereof;

(7) willfully to deceive or attempt to deceive such other person by any means whatsoever in regard to any such order or contract or the disposition or execution of any such order or contract, or in regard to any act of agency performed with respect to such order or contract for such person; or

(8) to bucket such order, or to fill such order by offset against the order or orders of any other person, or willfully and knowingly and without the prior consent of such person to become the buyer in respect to any selling order of such person, or become the seller in respect to any buying order of such person.

Commodity Exchange Act
§ 4o, 7 U.S.C. § 6o

(1) It shall be unlawful for a commodity trading advisor, associated person of a commodity trading advisor, commodity pool operator, or associated person of commodity pool operator by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly -

(9) to employ any device, scheme or artifice to defraud any client or participant or prospective client or participant; or

(10) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.

(2) It shall be unlawful for any commodity trading advisor, associated person of a commodity trading advisor, commodity pool operator, or associated person of a commodity pool operator registered under this Act to represent or imply in any manner whatsoever that such person has been sponsored, recommended, or approved, or that such persons's abilities or qualifications have in any respect been passed upon, by the United States or any officer

thereof. This section shall not be construed to prohibit a statement that a person is registered under this Act as a commodity trading advisor, associated person of a commodity trading advisor, commodity pool operator, or associated person of a commodity pool operator, if such statement is true in fact and if the effect of such registration is not misrepresented.